

PRECISION OPTICS CORPORATION INC
Form 10-Q
November 16, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

- x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2009

or

- o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

Commission File Number: 001-10647

PRECISION OPTICS CORPORATION, INC.

(Exact name of registrant as specified in its charter)

Massachusetts
(State or other jurisdiction of
incorporation or organization)

04-2795294
(I.R.S. Employer
Identification No.)

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22 East Broadway, Gardner, Massachusetts 01440-3338

(Address of principal executive offices) (Zip Code)

(978) 630-1800

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer
(Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). Yes No

The number of shares outstanding of the issuer's common stock, par value \$0.01 per share, at November 13, 2009 was 1,018,411 shares.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

	September 30, 2009	June 30, 2009
<u>ASSETS</u>		
CURRENT ASSETS		
Cash and Cash Equivalents	\$ 346,671	\$ 384,593
Accounts Receivable, net	435,889	511,807
Inventories, net	701,250	709,155
Prepaid Expenses	18,615	42,617
Total Current Assets	1,502,425	1,648,172
PROPERTY AND EQUIPMENT		
Machinery and Equipment	2,353,697	2,352,634
Leasehold Improvements	553,596	553,596
Furniture and Fixtures	148,303	148,303
Vehicles	42,343	42,343
	3,097,939	3,096,876
Less: Accumulated Depreciation	(2,981,416)	(2,968,503)
Net Property and Equipment	116,523	128,373
OTHER ASSETS		
Patents, net	197,910	198,643
Total Other Assets	197,910	198,643
TOTAL ASSETS	\$ 1,816,858	\$ 1,975,188
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
CURRENT LIABILITIES		
10% Senior Secured Convertible Notes	\$ 528,979	\$ 464,104
Accounts Payable	386,710	428,282
Customer Advances		12,393
Accrued Employee Compensation	520,333	504,187
Accrued Professional Services	42,500	58,000
Accrued Warranty Expense	25,000	25,000
Other Accrued Liabilities		912
Total Current Liabilities	1,503,522	1,492,878
STOCKHOLDERS' EQUITY		
Common Stock, \$0.01 par value -		
Authorized - 50,000,000 shares		
Issued and Outstanding 1,018,411 shares at September 30, 2009 and at June 30, 2009	10,184	10,184
Additional Paid-in Capital	38,225,178	38,222,002
Accumulated Deficit	(37,922,026)	(37,749,876)
Total Stockholders' Equity	313,336	482,310
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 1,816,858	\$ 1,975,188

The accompanying notes are an integral part of these consolidated financial statements.

PRECISION OPTICS CORPORATION, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE THREE MONTHS ENDED

SEPTEMBER 30, 2009 AND 2008

(UNAUDITED)

	Three Months Ended September 30,				
	2009		2008		
Revenues	\$	623,384	\$	659,735	
Cost of Goods Sold		404,358		355,593	
Gross Profit		219,026		304,142	
Research and Development Expenses, net		14,647		176,610	
Selling, General and Administrative Expenses		312,686		371,949	
Gain on Sale of Assets		(870)			
Total Operating Expenses		326,463		548,559	
Operating Loss		(107,437)		(244,417)	
Interest Income		162		2,951	
Interest Expense		(64,875)		(185,475)	
Net Loss	\$	(172,150)	\$	(426,941)	
Expenses					
Property operations		16,256	18,093	32,678	36,334
Real estate taxes		5,024	4,070	10,160	8,037
Cost of manufactured homes sold		2,565	14,672	4,874	22,050
Retail home sales, finance and insurance		2,830	3,544	4,728	6,884
Property management		1,586	2,366	3,178	4,513
General and administrative		4,991	6,389	9,412	11,883
Depreciation and amortization		21,775	18,762	43,386	35,057
Loss on sale of airplane				541	
Net consumer finance interest expense			204		650
Interest expense		20,006	17,036	39,587	32,724
Total expenses		75,033	85,136	148,544	158,132
Interest income		(448)	(269)	(871)	(641)
Loss from continuing operations before income tax benefit and allocation to minority interest		(13,118)	(16,580)	(25,972)	(30,467)
Income tax benefit from continuing operations		3,372		4,571	
Loss from continuing operations before allocation to minority interest		(9,746)	(16,580)	(21,401)	(30,467)
Minority interest		166	628	402	1,172
Loss from continuing operations		(9,580)	(15,952)	(20,999)	(29,295)
Income from discontinued operations		689	302	2,381	1,083

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Gain (loss) on sale of discontinued operations	15,613	52	25,909	(678)
Income tax expense from discontinued operations	(6,521))	(11,316))
Minority interest in discontinued operations	(343)	) (17	) (596	) (19
Net loss	(142)	) (15,615	) (4,621	) (28,909
Preferred stock dividend	(2,578)	) (2,578	) (5,156	) (5,156
Net loss attributable to common stockholders	\$ (2,720)	) \$ (18,193	) \$ (9,777	) \$ (34,065)
Loss per share from continuing operations				
Basic loss per share	\$ (0.28)	) \$ (0.43)	) \$ (0.60)	) \$ (0.80)
Diluted loss per share	\$ (0.28)	) \$ (0.43)	) \$ (0.60)	) \$ (0.80)
Income per share from discontinued operations				
Basic income per share	\$ 0.22	) \$ 0.01	) \$ 0.38	) \$ 0.01
Diluted income per share	\$ 0.22	) \$ 0.01	) \$ 0.38	) \$ 0.01
Loss per share attributable to common stockholders				
Basic loss per share	\$ (0.06)	) \$ (0.42)	) \$ (0.22)	) \$ (0.79)
Diluted loss per share	\$ (0.06)	) \$ (0.42)	) \$ (0.22)	) \$ (0.79)
Weighted average share information				
Basic shares outstanding	43,696	43,257	43,632	43,249

The accompanying notes are an integral part of these consolidated financial statements.

AFFORDABLE RESIDENTIAL COMMUNITIES INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED JUNE 30, 2006 and 2005
(in thousands) (unaudited)

	Six Months Ended June 30, 2006 (as restated)	2005
Cash flow from operating activities		
Net income (loss)	\$ (4,621)	\$ (28,909)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	43,386	35,057
Intra-period income taxes	6,745	
Adjustments to fair value for interest rate caps	(436)	227
Amortization of loan origination costs	3,045	3,421
Stock grant compensation expense	98	326
Partnership preferred unit distributions declared	552	786
Minority interest	(954)	(1,958)
Depreciation and minority interest included in income from discontinued operations	801	3,801
(Gain) loss on sale of discontinued operations	(25,909)	678
Loss on sale of airplane	541	
Gain on sale of manufactured homes	(791)	(1,804)
Changes in operating assets and liabilities	(7,002)	(10,636)
Net cash provided by operating activities	15,455	989
Cash flow from investing activities		
Purchases of manufactured homes	(6,693)	(68,300)
Proceeds from community sales	123,431	48,721
Proceeds from manufactured home sales	5,428	13,014
Proceeds from sale of airplane	1,170	
Community improvements and equipment purchases	(2,055)	(32,605)
Restricted cash	374	3,609
Loan reserves	(3,547)	(4,227)
Net cash provided by (used in) investing activities	118,108	(39,788)
Cash flow from financing activities		
Proceeds from issuance of debt	30,535	155,483
Repayment of debt	(147,372)	(94,352)
Deposits on refinance transaction	(4,900)	
Payment of common dividends and OP unit distributions		(27,045)
Payment of preferred dividends	(5,156)	(5,156)
Payment of partnership preferred distributions	(552)	(786)
Repurchase of OP Units		(1,836)
Loan origination costs	(1,849)	(3,879)
Net cash (used in) provided by financing activities	(129,294)	22,429
Net increase (decrease) in cash and cash equivalents	4,269	(16,370)
Cash and cash equivalents, beginning of period	27,926	32,859
Cash and cash equivalents, end of period	\$ 32,195	\$ 16,489
Non-cash financing and investing transactions:		
Notes receivable for manufactured home sales	\$ 3,740	\$ 11,402
Fair value of OP Units redeemed for common stock	\$ 3,176	\$
Supplemental cash flow information:		
Cash paid for interest	\$ 40,187	\$ 33,931

The accompanying notes are an integral part of these consolidated financial statements.

AFFORDABLE RESIDENTIAL COMMUNITIES INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Business, Basis of Presentation and Summary of Significant Accounting Policies

Business

Affordable Residential Communities Inc. is a Maryland corporation that is engaged in the acquisition, renovation, repositioning and operation of primarily all-age manufactured home communities, the retail sale and financing of manufactured homes, the rental of manufactured homes and other related businesses including acting as agent in the sale of homeowners insurance and related products, all exclusively to residents in our communities. We were organized in July 1998 and operate primarily through Affordable Residential Communities LP (the Operating Partnership or OP) and its subsidiaries, of which we are the sole general partner and owned 96.5% as of June 30, 2006.

On March 30, 2006, the Company elected not to be taxed as a Real Estate Investment Trust (REIT) for the year ending December 31, 2006 primarily because, in certain circumstances, gains on sales of properties that the Company realized in 2006 could have resulted in a Federal income tax liability equal to the amount of the gain for Federal income tax purposes (a 100% tax rate) if the Company had elected to remain a REIT.

As of June 30, 2006, we owned and operated 275 communities (excluding five communities classified as discontinued operations, see Note 10) consisting of 57,240 homesites (net of 1,108 homesites classified as discontinued operations) in 23 states with occupancy of 83.5%. Our five largest markets are Dallas-Fort Worth, Texas, with 12.5% of our total homesites; Atlanta, Georgia, with 8.7% of our total homesites; Salt Lake City, Utah, with 6.6% of our total homesites; the Front Range of Colorado, with 5.7% of our total homesites; and Kansas City-Lawrence-Topeka, with 4.2% of our total homesites. We also conduct a retail home sales business.

Our common stock is traded on the New York Stock Exchange under the symbol ARC. Our Series A Cumulative Redeemable Preferred Stock is traded on the New York Stock Exchange under the symbol ARC-PA. We have no public trading history prior to February 12, 2004.

Basis of Presentation

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America and in conformity with the rules and regulations of the Securities and Exchange Commission requires us to make estimates and assumptions that affect the reported amount of assets and liabilities, the disclosure of contingent assets and liabilities and the reported amount of revenues and expenses during the reporting period. Actual results may differ from previously estimated amounts.

The interim consolidated financial statements presented herein reflect all adjustments that are necessary to fairly present the financial position, results of operations and cash flows of the Company, and all such adjustments are of a normal and recurring nature. The results of operations for the interim period ended June 30, 2006 are not necessarily indicative of the results that may be expected for the year ended December 31, 2006. The December 31, 2005 condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. These financial statements should be read in conjunction with the financial statements included in our Current Report on Form 8-K for the year ended December 31, 2005 filed on October 5, 2006.

The accompanying consolidated financial statements include all of our accounts, which include the results of operations of the manufactured home communities acquired only for the periods subsequent to the date of acquisition. We have eliminated all significant inter-company balances and transactions.

We have reclassified certain prior period amounts to conform to the current year presentation.

Summary of Significant Accounting Policies*Rental and Other Property*

We carry rental property at cost, less accumulated depreciation. We capitalize significant renovations and improvements that extend the useful life of assets and depreciate them over their estimated remaining useful lives. We expense maintenance and repairs as incurred. Depreciation is computed primarily using the straight-line method over the estimated useful lives of the assets. The estimated useful lives of the various classes of rental property assets are as follows:

Asset Class	Estimated Useful Lives (Years)
Manufactured home communities and improvements	10 to 30
Buildings	10 to 20
Rental homes	10 or rent-to-own term
Furniture and other equipment	5
Computer software and hardware	3

We evaluate the recoverability of our investment in rental property whenever events or changes in circumstances indicate that the recoverability of the net book value of the asset is questionable. Our assessment of the recoverability of rental property includes, but is not limited to, recent operating results and expected net operating cash flows from future operations. In the event that facts and circumstances indicate that the carrying amount of rental property may be impaired, we perform an evaluation of recoverability in which we compare the estimated future undiscounted cash flows associated with the asset to the asset's carrying amount to determine if an impairment adjustment is required. If this review indicates that the asset's carrying amount will not be fully recoverable, we will reduce the carrying value of the asset to its estimated fair value. We recorded no impairment charges during the six months ended June 30, 2006 and 2005.

Restricted Stock Grants

During 2004 we granted 95,000 shares of restricted common stock that vest over five years. In June 2004, 42,500 of these restricted shares were forfeited and in October 2004, an additional 37,500 shares of restricted stock were forfeited pursuant to the terms of their issuance, leaving 15,000 restricted shares outstanding. During both of the six month periods ended June 30, 2006 and 2005, 3,000 shares vested leaving 9,000 shares unvested at June 30, 2006. We have recorded the unvested portion of the remaining 9,000 outstanding restricted shares as of June 30, 2006 in additional paid-in capital and are amortizing the balance ratably over the vesting period. We recorded \$14,000 and \$28,000, respectively, in compensation expense related to these restricted shares during both of the three and six month periods ended June 30, 2006 and 2005. In accordance with SFAS No. 123(R) (see Recent Statements of Financial Accounting Standards below) unearned compensation continues to be amortized over the vesting period but is now included as part of additional paid-in capital on the consolidated balance sheets. We expect that there will be no forfeitures of the unvested restricted stock outstanding at June 30, 2006.

We consider the number of vested shares issued under our 2003 equity incentive plan as common stock outstanding and include them in the denominator of our calculation of basic earnings per share. We also consider the total number of unvested restricted shares granted under our 2003 equity incentive plan in the denominator of our calculation of diluted earnings per share if they are dilutive. We return shares forfeited to the 2003 equity incentive plan as shares eligible for future grant and adjust any compensation expense previously recorded on such shares in the period the forfeiture occurs.

Income Taxes

Deferred tax assets and liabilities are recorded for the estimated future tax effects of the temporary difference between the tax basis and book basis of assets and liabilities reported in the accompanying consolidated balance sheets. Deferred tax assets are reduced by a valuation allowance to the extent that their benefits are not expected to be realized. At June 30, 2006, a valuation allowance of \$74.9 million was recorded to reduce deferred tax assets to the amount expected to be recoverable.

We allocate income taxes between continuing and discontinued operations in accordance with Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* (SFAS No. 109), particularly paragraph 140. We recognize interim income tax benefits in continuing operations on the effective rate method and income tax expense in discontinued operations without such pro-ration in accordance with Accounting Principles Bulletin 28, *Interim Financial Reporting* (APB 28) and FASB Interpretations 18, *Accounting for Income Taxes in Interim Periods - An interpretation of APB Opinion No. 28* (FIN 18).

Accumulated Other Comprehensive Income and Comprehensive Loss

Amounts recorded in accumulated other comprehensive income as of December 31, 2005 represent unrecognized gains on our interest rate swap, which qualified as a cash flow hedge and was marked to market over the life of the instrument. Including these unrecognized gains or losses, our comprehensive loss for the three and six months ended June 30, 2006 was \$2.7 million and \$10.4 million, respectively, compared with a comprehensive loss of \$18.5 million and \$34.1 million, respectively, during the same periods in 2005. Our interest rate swap agreement expired in February 2006 and was not renewed.

Recent Statements of Financial Accounting Standards

On December 16, 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (SFAS No. 123(R)), which is a revision of SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS No. 123). SFAS No. 123(R) became effective on January 1, 2006 and we have adopted the standard using the modified prospective method. Since our only share based payments are nominal restricted stock issuance and shares issued to members of the board of directors as compensation, the implementation of SFAS No. 123(R) did not have a material impact on our financial position as of June 30, 2006 or our operations or cash flows for the three months ended June 30, 2006.

2. Restatement

On March 8, 2007, the Audit Committee of the Board of Directors of Affordable Residential Communities Inc. (the Company) determined that the Company should restate its unaudited consolidated financial statements as of and for the quarterly periods ended March 31, 2006, June 30, 2006 and September 30, 2006, to correct the allocation of income taxes (intra-period tax allocation) between continuing operations and discontinued operations for the first three quarters of 2006, as more fully described below. The Company does not expect any aggregate income tax expense or benefit for the year ended December 31, 2006. The above corrections do not have an adverse impact on any covenants associated with the Company's debt facilities.

Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* (SFAS 109), requires that a company with a loss from continuing operations consider all items reported apart from continuing operations (for example extraordinary items, discontinued operations and other comprehensive income) in determining the tax benefit that results from a loss from continuing operations. In our case, because we had a loss from continuing operations and a gain from discontinued operations in each of the periods referenced above, in accordance with SFAS 109 and Emerging Issues Task Force Topic D32, *Intra-period Tax Allocation of the Tax Effect of Pre-Tax Income from Continuing Operations*, we should have considered the gain from discontinued operations in determining the amount of tax benefit to allocate to continuing operations. However, we originally determined the allocation of income taxes (intra-period allocation) between continuing and discontinued operations using a with and without methodology. That is, we did not believe that a tax benefit resulted from the loss from continuing operations because we did not believe there was an incremental benefit from the loss generated from our continuing operations. Additionally, we believed that the gain from discontinued operations did not attract a tax consequence.

In accordance with FASB Interpretation No. 18, *Accounting for Income Taxes in Interim Periods - An Interpretation of APB Opinion No. 28*, the tax benefit recognized in continuing operations is calculated using an effective rate methodology and therefore will be provided for over the course of the year. The tax expense recognized in discontinued operations is recognized on a discrete basis and therefore the entire amount of tax expense is recognized at the time the pretax gain on the discontinued operations is recognized. This mismatch in the timing of the recognition of tax benefits and expense resulted in a restatement of the net loss for the quarter and six months ended June 30, 2006.

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The impact of the restatement on our consolidated balance sheet and consolidated statement of operations is outlined in the table below (dollars in thousands). This restatement did not have an impact on our cash flows from operating, investing or financing activities or periods prior to 2006. The previously reported amounts have been recast for discontinued communities. However, the associated amounts were not separately reflected as they were considered immaterial to the presentation. Intra-period taxes are included in tenant deposits and other liabilities. In accordance with SFAS No. 128, Earnings per Share, our basic and diluted weighted average shares outstanding have been increased by a factor of approximately 1.06 to reflect the dilutive impact of our January 2007 rights offering in which ten million shares of our common stock were purchased by our stockholders at the below-market price of \$8.00 per share.

	As of June 30, 2006	
	Previously Reported	As Restated
Consolidated Balance Sheet		
Tenant deposits and other liabilities	\$ 16,340	\$ 22,640
Total liabilities	\$ 1,128,862	\$ 1,135,162
Minority interest	\$ 29,195	\$ 28,972
Retained deficit	\$ (470,907)	\$ (476,984)
Total stockholders' equity	\$ 442,482	\$ 436,405
Total liabilities and stockholders' equity	\$ 1,600,539	\$ 1,600,539

Consolidated Statement of Operations	Three Months Ended June 30, 2006		Six Months Ended June 30, 2006	
	Previously Reported	As Restated	Previously Reported	As Restated
Loss from continuing operations before income tax benefit and allocation to minority interest	\$ (13,118)	\$ (13,118)	\$ (25,972)	\$ (25,972)
Income tax benefit from continuing operations		3,372		4,571
Loss before allocation to minority interest	(13,118)	(9,746)	(25,972)	(21,401)
Minority interest	284	166	562	402
Loss from continuing operations	(12,834)	(9,580)	(25,410)	(20,999)
Income from discontinued operations	689	689	2,381	2,381
Gain on sale of discontinued operations	15,613	15,613	25,909	25,909
Income tax expense from discontinued operations	(74)	(6,521)	(445)	(11,316)
Minority interest in discontinued operations	(569)	(343)	(979)	(596)
Net loss	2,825	(142)	1,456	(4,621)
Preferred stock dividend	(2,578)	(2,578)	(5,156)	(5,156)
Net loss attributable to common stockholders	\$ 247	\$ (2,720)	\$ (3,700)	\$ (9,777)
Loss per share from continuing operations				
Basic loss per share	\$ (0.35)	\$ (0.28)	\$ (0.70)	\$ (0.60)
Diluted loss per share	\$ (0.35)	\$ (0.28)	\$ (0.70)	\$ (0.60)
Income per share from discontinued operations				
Basic income per share	\$ 0.36	\$ 0.22	\$ 0.62	\$ 0.38
Diluted income per share	\$ 0.36	\$ 0.22	\$ 0.62	\$ 0.38
Loss per share attributable to common stockholders				
Basic loss per share	\$ 0.01	\$ (0.06)	\$ (0.08)	\$ (0.22)
Diluted loss per share	\$ 0.01	\$ (0.06)	\$ (0.08)	\$ (0.22)
Weighted average common shares outstanding	43,696	43,696	43,632	43,632

3. Common Stock, Preferred Stock and Minority Interest Related Transactions

On March 2, 2006, the board of directors declared a quarterly cash dividend of \$0.515625 per share for its Series A Cumulative Redeemable Preferred Stock, and \$0.39 per unit on the Series C Preferred Operating Partnership Units of Affordable Residential Communities LP. The dividends were paid on April 28, 2006 to shareholders of record on April 14, 2006. On June 8, 2006, the board of directors declared a quarterly cash dividend of \$0.515625 per share for its Series A Cumulative Redeemable Preferred Stock, and \$0.39 per unit on the Series C Preferred Operating Partnership Units of Affordable Residential Communities LP. The dividends were paid on July 28, 2006 to shareholders of record on July 14, 2006. The Board reviews the payment of dividends on a quarterly basis.

At June 30, 2006, minority interest consisted of 1,503,093 OP Units that were issued to various limited partners and 705,688 preferred partnership units (PPU s) issued on June 30, 2004 as part of the D.A.M. portfolio acquisition. Each OP Unit outstanding is paired with 1.9268 shares of our special voting stock (each a Paired Equity Unit) that allows each holder to vote an OP Unit on matters as if it were a common share of our stock. Each OP Unit is redeemable for cash, or at our election, convertible into one share of our common stock. During the three and six months ended June 30, 2006, we converted approximately 14,000 and 328,000 OP Units, respectively, for an equal number of shares of our common stock valued at \$141,400 and \$3.2 million, respectively.

The PPU s outstanding as of June 30, 2006 consist of 705,688 Series C units. The Series C PPU s carry a liquidation preference of \$25 per unit and earn cash distributions at the rate of 6.25% per annum, payable quarterly. The Series C PPU s can be redeemed at the option of the Operating Partnership for cash after the fifth anniversary of their issuance. Series C PPU holders can request redemption of their units after the two and a half year anniversary of issuance, at which time the Operating Partnership must redeem the PPU s or repurchase them with common stock, cash and/or a note payable, at the Operating Partnership s option. As of June 30, 2006, we had accrued \$183,773 of the Series C PPU preferred distribution, representing the portion of the preferred distribution earned by Series C preferred unitholders through that date.

We have recorded an equity transfer adjustment between additional paid-in capital and the minority interest in our consolidated balance sheet as of June 30, 2006 to account for changes in the respective ownership in the underlying equity of the Operating Partnership.

The following summarizes the activity of the minority interest in the Operating Partnership (in thousands):

	(as restated)
Minority interest at December 31, 2005	\$ 31,902
Minority interest allocation	194
Transfer from stockholders equity	604
Redemption of OP Units.	(3,176)
Distributions to PPU holders	(552)
Minority interest at June 30, 2006	\$ 28,972

4. Rental and Other Property, Net

The following summarizes rental and other property (in thousands):

	June 30, 2006	December 31, 2005
Land	\$ 194,306	\$ 194,331
Improvements to land and buildings	1,190,153	1,190,102
Rental homes and improvements	262,850	261,164
Furniture, equipment and vehicles	13,576	16,041
Subtotal	1,660,885	1,661,638
Less accumulated depreciation:		
On improvements to land and buildings	(186,331)	(164,186)
On rental homes and improvements	(50,052)	(37,077)
On furniture, equipment and vehicles	(7,051)	(7,278)
Rental and other property, net	\$ 1,417,451	\$ 1,453,097

5. Notes Payable

The following table sets forth certain information regarding our notes payable (in thousands):

	June 30, 2006	December 31, 2005
Senior fixed rate mortgage due 2009, 5.05% per annum	\$ 87,237	\$ 89,512
Senior fixed rate mortgage due 2012, 7.35% per annum	279,761	286,433
Senior fixed rate mortgage due 2014, 5.53% per annum	194,169	196,270
Senior variable rate mortgage due 2007, one-month LIBOR plus 3.00% per annum (8.33% at June 30, 2006)	116,757	126,297
Various individual fixed rate mortgages due 2006 through 2031, averaging 7.23% per annum at June 30, 2006	135,239	150,104
Revolving credit mortgage facility due 2006, one-month LIBOR plus 2.75% per annum (8.08% at June 30, 2006)	58,764	58,764
Floorplan line of credit due 2007, ranging from prime plus 0.75% to prime plus 4.00% per annum (9.00% at June 30, 2006)	4,513	14,188
Trust preferred securities due 2035, three-month LIBOR plus 3.25% per annum (8.73% at June 30, 2006)	25,780	25,780
Consumer finance facility due 2008, one-month LIBOR plus 3.00% per annum (8.33% at June 30, 2006)	19,345	18,607
Lease receivable facility due 2008, one-month LIBOR plus 4.125% per annum (9.46% at June 30, 2006)	41,300	77,500
Senior exchangeable notes due 2025, 7.50% per annum	96,600	96,600
D.A.M. PPU notes payable due 2006, 7.00% per annum	2,499	4,999
Other loans	1,230	1,277
	\$ 1,063,194	\$ 1,146,331

Senior Fixed Rate Mortgage Due 2009

The Senior Fixed Rate Mortgage due 2009 is an obligation of certain real property subsidiaries of the Operating Partnership and is collateralized by 26 manufactured home communities owned by these subsidiaries. The Senior Fixed Rate Mortgage due 2009 bears interest at a fixed rate of 5.05%, is being amortized based on a 30-year amortization schedule and matures on March 1, 2009. Pursuant to the terms of the mortgage agreement, we have established reserves relating to the mortgaged properties for real estate taxes, insurance, capital spending and property operating expenditures. The Senior Fixed Rate Mortgage due 2009 contains customary defeasance-based prepayment penalties for repayments made prior to maturity.

Senior Fixed Rate Mortgage Due 2012

The Senior Fixed Rate Mortgage due 2012 is an obligation of certain of our special purpose real property subsidiaries and is collateralized by 98 manufactured home communities. The Senior Fixed Rate Mortgage due 2012 bears interest at a fixed rate of 7.35% per annum, is amortized based on a 30-year schedule and matures on May 1, 2012. Pursuant to the terms of the mortgage agreement, we have established reserves relating to the mortgaged properties for real estate taxes, insurance, capital spending and property operating expenditures. The Senior Fixed Rate Mortgage due 2012 contains customary defeasance-based prepayment penalties for repayments made prior to maturity.

Senior Fixed Rate Mortgage Due 2014

The Senior Fixed Rate Mortgage due 2014 is an obligation of certain real property subsidiaries of the Operating Partnership and is collateralized by 43 manufactured home communities owned by these subsidiaries. The Senior Fixed Rate Mortgage due 2014 bears interest at a fixed rate of 5.53% per annum, is amortized based on a 30-year schedule and matures on March 1, 2014. Pursuant to the terms of the mortgage agreement, we have established reserves relating to the mortgaged properties for real estate taxes, insurance, capital spending and property operating expenditures. The Senior Fixed Rate Mortgage due 2014 contains customary defeasance-based prepayment penalties for repayments made prior to maturity.

Senior Variable Rate Mortgage Due 2007

In February 2006, we extended the maturity of our Senior Variable Rate Mortgage to February 2007 in accordance with the terms of the mortgage. On July 11, 2006, we entered into a \$230 million mortgage debt facility. Approximately \$117 million of the proceeds were used to repay our Senior Variable Rate Mortgage. The Loan Agreement is comprised of two components (collectively, the Loan): a \$170 million 10-year fixed rate mortgage debt component and a \$60 million 3-year floating rate mortgage debt component with two one-year (no-fee) extension options. The fixed rate component bears interest at 6.239% and requires interest-only payments for the term of the loan. The floating rate component is adjusted monthly, bears interest at one-month LIBOR plus 80 basis points and requires interest-only payments for the term of the loan.

Various Individual Fixed Rate Mortgages

We have assumed various individual fixed rate mortgages in connection with the acquisition of various properties that were encumbered at the time of acquisition as follows:

- a) Mortgages assumed as part of individual property purchases. These notes total approximately \$39.8 million at June 30, 2006, mature from 2006 (\$5.2 million in 2006) through 2028 and have an average effective interest rate of 7.46%. These mortgages are secured by 13 specific manufactured home communities.
- b) Mortgages assumed in conjunction with the Hometown acquisition. These notes total approximately \$67.8 million, mature from 2008 through 2031 and carry an average effective interest rate of 7.12%. These mortgages are secured by 12 specific manufactured home communities and subject to early pre-payment penalties, the terms of which vary from mortgage to mortgage.
- c) Notes assumed in conjunction with the D.A.M. portfolio purchase. These notes total approximately \$27.6 million, mature in 2008 and carry an average effective annual interest rate of 7.18%. These mortgages are secured by 24 specific manufactured home communities.

Revolving Credit Mortgage Facility

On July 11, 2006, we entered into a \$230 million mortgage debt facility. Approximately \$59 million of the proceeds were used to repay our Revolving Credit Mortgage Facility. The Loan Agreement is comprised of two components (collectively, the Loan): a \$170 million 10-year fixed rate mortgage debt component and a \$60 million 3-year floating rate mortgage debt component with two one-year (no-fee) extension options. The fixed rate component bears interest at 6.239% and requires interest-only payments for the term of the loan. The floating rate component is adjusted monthly, bears interest at one-month LIBOR plus 80 basis points and requires interest-only payments for the term of the loan.

Floorplan Lines of Credit

Our floorplan line of credit provides for borrowings of up to \$35.0 million, secured by manufactured homes in inventory. Under the lines of credit, the lender will advance 75% of the cost of manufactured homes. Repayments of borrowed amounts are due upon sale or lease of the related manufactured home. Advances under the lines of credit bear interest ranging from the prime rate plus 0.75% to the prime rate plus 4.00% (averaging 9.00% at June 30, 2006) based on the length of time each advance has been outstanding. Monthly curtailment payments are required for unsold homes beginning 360 days following the purchase of the home. The required curtailment payment will be between 3.00% and 5.00% of the home's original invoice amount depending on the type of home and the number of months since the home's purchase. The lines of credit require us to maintain a minimum tangible net worth, a maximum debt to tangible net worth ratio of 3 to 1, and minimum cash and cash equivalents of \$15.0 million, all as defined in the agreement. The minimum tangible net worth required is \$425.0 million through December 31, 2006, and \$385.0 million from January 1, 2007 through September 13, 2007, the due date of the line. We are in compliance with all financial covenants of the line of credit as of June 30, 2006. The line of credit is subject to an annual commitment fee of \$250,000, an unused line fee of .25% per annum and a termination fee of 1.00% to 3.00%, based on the termination date.

Trust Preferred Securities Due 2035

On March 15, 2005, the Company issued \$25.8 million in unsecured trust preferred securities. The \$25.8 million trust preferred securities bear interest at three-month LIBOR plus 3.25% (8.73% at June 30, 2006). Interest on the securities is paid on the 30th of March, June, September and December of each year. The Company may redeem these securities on or after March 30, 2010 in whole or in part at principal amount plus accrued interest. The securities are mandatorily redeemable on March 15, 2035 if not redeemed sooner.

Consumer Finance Facility

The Consumer Finance Facility has a total commitment of \$125.0 million and a term of four years. This facility is an obligation of a subsidiary of our Operating Partnership, and borrowings under this facility are secured by manufactured housing conditional sales contracts. Borrowings under the facility are limited by specified borrowing base requirements related to the value of the collateral securing the facility (\$19.3 million as of June 30, 2006). The facility bears interest at a variable rate based upon a spread of 3.00% over the one-month LIBOR (8.33% at June 30, 2006). During the quarter, we paid a commitment fee of 1.00% on the original committed amount and 0.75% of the amended committed amount and will pay additional annual commitment fees payable on each anniversary of the closing. Advances under the facility are subject to a number of conditions, including certain underwriting and credit screening guidelines and the conditions that the home must be located in one of our communities, the loan term may not exceed 12 years for a single-section home or 15 years for a multi-section home and the loan amount shall not exceed 90% of the value of the home securing the conditional sales contract.

The line of credit requires the Operating Partnership to maintain a minimum tangible net worth, a maximum debt to tangible net worth ratio of 3 to 1, and minimum cash and cash equivalents of \$15.0 million, all as defined in the agreement. The minimum tangible net worth required is \$425.0 million through December 31, 2006, \$385.0 million from January 1, 2007 through December 31, 2007, and \$355.0 million from January 1, 2008 through September 30, 2008. We were in compliance as of June 30, 2006 with all financial covenants under the line of credit.

The availability of advances under the Consumer Finance Facility is subject to certain conditions that are beyond our control. Conditions that could result in our inability to draw on these facilities include a downgrade in the credit rating of the lender and the absence of certain markets for financing debt obligations secured by securities or mortgage loans. Funding under this facility may also be denied if the lender determines that the value of the assets serving as collateral would be insufficient to maintain the required 75% loan-to-value ratio upon giving effect to a request for funding. The lender can also at any time require that we prepay amounts funded or provide additional collateral if, in its judgment, this is necessary to maintain the 75% loan-to-value ratio.

Lease Receivables Facility

The Company has a \$150.0 million secured revolving credit facility (the Lease Receivables Facility) which we use to finance the purchase of manufactured homes and for general corporate purposes. Pursuant to the agreement, borrowings are limited to approximately 65% of the net book value of the eligible manufactured housing units owned by two of our indirect wholly owned subsidiaries, ARC Housing LLC and ARC HousingTX LP (collectively, Housing) and located in ARC's communities, subject to certain other applicable borrowing base requirements. The facility bears interest at a variable rate based on a spread of 4.125% over the one-month LIBOR (9.46% at June 30, 2006). The facility matures September 30, 2008.

The line of credit requires the Operating Partnership to maintain a minimum tangible net worth, a maximum debt to tangible net worth ratio of 3 to 1, and minimum cash and cash equivalents of \$15.0 million, all as defined in the agreement. The minimum tangible net worth required is \$425.0 million through December 31, 2006, \$385.0 million from January 1, 2007 through December 31, 2007, and \$355.0 million from January 1, 2008 through September 30, 2008. We were in compliance as of June 30, 2006 with all financial covenants under the amended line of credit. Borrowings under the Lease Receivables Facility are secured by an assignment of all lease receivables and rents, an assignment of the underlying manufactured homes and a pledge by ARHC LLC and ARC Housing GP LLC of 100% of the outstanding equity in Housing. Interest is payable monthly.

Senior Exchangeable Notes Due 2025

In August 2005, our Operating Partnership issued \$96.6 million aggregate principal amount of 7.50% senior exchangeable notes due 2025 to qualified institutional buyers in a private transaction. The notes are senior unsecured obligations of the OP and are exchangeable, at the option of the holders, into shares of ARC common stock at an initial exchange rate of 69.8812 shares per \$1,000 principal amount of the notes (equal to an initial exchange price of approximately \$14.31 per share), subject to adjustment and, in the event of specified corporate transactions involving ARC or the OP, an additional make-whole premium. Upon exchange, the OP shall have the option to deliver, in lieu of shares of ARC common stock, cash or a combination of cash and shares of ARC common stock.

Prior to August 20, 2010, the notes are not redeemable at the option of the OP. After August 20, 2010, the OP may redeem all or a portion of the notes at a redemption price equal to the principal amount plus accrued and unpaid interest, if any, on the notes, if the closing price of ARC common stock has exceeded 130% of the exchange price for at least 20 trading days in any consecutive 30-trading day period.

Holders of the notes may require the OP to repurchase all or a portion of the notes at a purchase price equal to the principal amount plus accrued and unpaid interest, if any, on the notes on each of August 15, 2010, August 15, 2015, and August 15, 2020, or after the occurrence of certain corporate transactions involving ARC or the OP.

In connection with the sale and issuance of the notes, ARC is required to maintain the effectiveness of a registration rights agreement with the SEC with respect to the notes after February 5, 2006 (or 180 days following the issuance of the notes) or pay liquidated damages to the holders of the notes for each day following the date of ineffectiveness equal to an annual rate of 0.25% of the principal amount of the notes for the first 90 days following the ineffectiveness and 0.50% thereafter. ARC obtained the initial declaration of effectiveness of the registration statement on May 8, 2006 and incurred liquidated damages of \$64,400 reflected in interest expense.

We have determined that, subsequent to the initial declaration of effectiveness of the registration statement, it is unlikely that events will occur that could trigger the payment of any additional liquidated damages and, accordingly, have assigned a nominal value to the liquidated damages provision.

In August 2005, our Operating Partnership issued \$96.6 million aggregate principal amount of 7.50% senior exchangeable preferred stock.

D.A.M. PPU Notes Payable Due 2006

According to the terms of our Series B PPUs, in July 2005 the Series B PPU holders requested redemption of their units, and the Operating Partnership elected to repurchase them for approximately \$2.5 million in cash and notes payable totaling approximately \$5.0 million. A principal payment of approximately \$2.5 million plus interest accrued at 7.00% was made on January 18, 2006 and the final payment of approximately \$2.5 million plus interest accrued was made on July 18, 2006.

6. Income (loss) per share

In accordance with SFAS No. 128, Earnings per Share, our basic and diluted weighted average shares outstanding have been increased by a factor of approximately 1.06 to reflect the impact of our January 2007 rights offering in which ten million shares of our common stock were purchased by our stockholders at the below-market price of \$8.00 per share. The following reflects the calculation of income (loss) per share on a basic and diluted basis (in thousands, except per share information):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2006	2005	2006	2005
	(as restated)		(as restated)	
Loss per share from continuing operations:				
Loss from continuing operations	\$ (9,580)	\$ (15,952)	\$ (20,999)	\$ (29,295)
Preferred stock dividends	(2,578)	(2,578)	(5,156)	(5,156)
Net loss from continuing operations	\$ (12,158)	\$ (18,530)	\$ (26,155)	\$ (34,451)
Weighted average common shares outstanding	43,696	43,257	43,632	43,249
Basic loss per share from continuing operations	\$ (0.28)	\$ (0.43)	\$ (0.60)	\$ (0.80)
Diluted loss per share from continuing operations	\$ (0.28)	\$ (0.43)	\$ (0.60)	\$ (0.80)
Income per share from discontinued operations:				
Income from discontinued operations	\$ 689	\$ 302	\$ 2,381	\$ 1,083
Gain (loss) on sale of discontinued operations	15,613	52	25,909	(678)
Income tax expense from discontinued operations	(6,521)		(11,316)	
Minority interest in discontinued operations	(343)	(17)	(596)	(19)
Net income from discontinued operations	\$ 9,438	\$ 337	\$ 16,378	\$ 386
Basic income per share from discontinued operations	\$ 0.22	\$ 0.01	\$ 0.38	\$ 0.01
Diluted income per share from discontinued operations	\$ 0.22	\$ 0.01	\$ 0.38	\$ 0.01
Loss per share available to common stockholders:				
Net loss available to common stockholders	\$ (2,720)	\$ (18,193)	\$ (9,777)	\$ (34,065)
Basic loss per share to common stockholders	\$ (0.06)	\$ (0.42)	\$ (0.22)	\$ (0.79)
Diluted loss per share to common stockholders	\$ (0.06)	\$ (0.42)	\$ (0.22)	\$ (0.79)
Equivalent shares utilized for diluted loss per share calculation except when anti-dilutive:				
Operating partnership units (a)	1,600	2,522	1,656	2,532
Preferred partnership units (b)	1,737	1,993	1,737	1,993
Restricted stock	10	40	10	35
Total	3,347	4,555	3,403	4,560

(a) From June 30, 2005 through June 30, 2006, we redeemed approximately 755,000 OP units.

(b) In July 2005, we redeemed all of the Series B PPUs (see our Form 8-K for the year ended December 31, 2005 filed on October 5, 2006).

7. Property Operations Expense

During the three and six months ended June 30, 2006 and 2005, we incurred property operations expense as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 30, 2006	2005	June 30, 2006	2005
Utilities and telephone	\$ 7,062	\$ 6,260	\$ 14,202	\$ 13,303
Salaries and benefits	4,893	6,300	9,863	11,787
Repairs and maintenance	2,155	2,485	3,978	4,900
Insurance	819	974	1,681	1,891
Bad debt expense	293	485	693	1,179
Professional services	298	340	609	683
Office supplies	151	290	311	549
Advertising	26	76	52	238
Other operating expense	559	883	1,289	1,804
	\$ 16,256	\$ 18,093	\$ 32,678	\$ 36,334

8. Retail Home Sales, Finance and Insurance Expense

During the three and six months ended June 30, 2006 and 2005, we incurred retail home sales, finance and insurance expense as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 30, 2006	2005	June 30, 2006	2005
Salaries and benefits	\$ 1,837	\$ 1,547	3,079	3,080
Travel	117	213	166	358
Insurance	47	86	98	166
Bad debt expense	16	280	25	309
Professional services	195	244	428	399
Advertising	297	825	465	1,937
Other operating expense	321	349	467	635
	\$ 2,830	\$ 3,544	\$ 4,728	\$ 6,884

9. General and Administrative Expense

During the three and six months ended June 30, 2006 and 2005, we incurred general and administrative expense as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 30, 2006	2005	June 30, 2006	2005
Salaries and benefits	\$ 2,866	\$ 3,627	\$ 5,609	\$ 6,840
Travel	188	362	321	802
Professional services	880	1,219	1,511	2,209
Telephone	134	106	199	205
Office supplies	108	129	224	250
Insurance	309	349	566	466
Rent	136	59	200	128
Other administrative expense	370	538	782	983
	\$ 4,991	\$ 6,389	\$ 9,412	\$ 11,883

10. Discontinued Operations

As of December 31, 2005, we held 41 communities as discontinued operations. As of June 30, 2006, we had closed sales for 36 of these communities, comprising \$77.0 million of cash proceeds net of related debt, defeasance and other closing costs of \$59.6 million. Subsequent to June 30, 2006, we closed an additional four communities for \$8.4 million of cash proceeds net of related debt, defeasance and other closing costs of \$15.4 million. We expect to close the remaining sales transaction in 2007. There can be no assurance, however, that the Company will close the remaining community sale, or, if it closes, that it will close on the terms set forth in its contract.

In accordance with the provisions of Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-lived Assets, each of the communities designated as held for sale and not sold have been classified as discontinued operations as of June 30, 2006 and December 31, 2005. We have included \$30.4 million and \$132.3 million of assets related to these communities as assets held for sale in the accompanying consolidated balance sheets as of June 30, 2006 and December 31, 2005, respectively, and \$21.3 million and \$56.8 million, respectively, of mortgage notes payable and other obligations related to these communities as liabilities related to assets held for sale. In addition, we have recast the operations of each of these communities as discontinued operations in the accompanying statements of operations for the three and six months ended June 30, 2006 and 2005. In connection with sales of our discontinued operations, we recorded gains of \$15.6 million and \$25.9 million, respectively, in the three and six months ended June 30, 2006, and a loss of \$0.7 million in the six months ended June 30, 2005.

The following table summarizes combined balance sheet and income statement information for the discontinued operations noted above (in thousands):

	June 30, 2006	December 31, 2005
Assets Held for Sale		
Rental and other property, net	\$ 29,154	\$ 131,768
Tenant, notes and other receivables, net	44	665
Loan origination costs	288	752
Goodwill	1,398	6,481
Lease intangibles and customer relationships, net	204	1,110
Prepaid expenses and other assets	262	414
Reserve for loss on sales of communities	(941)	(8,850)
	\$ 30,409	\$ 132,340
Liabilities Related to Assets Held for Sale		
Notes payable	\$ 20,708	\$ 54,859
Accounts payable and accrued expenses	360	618
Tenant deposits and other liabilities	261	1,350
	\$ 21,329	\$ 56,827

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Statement of Operations				
Revenue	\$ 2,761	\$ 7,294	\$ 8,201	\$ 14,847
Operating expenses	(2,072)	(6,992)	(5,820)	(13,764)
Income from discontinued operations	\$ 689	\$ 302	\$ 2,381	\$ 1,083

11. Commitments and Contingencies

In the normal course of business, from time to time we are involved in legal actions relating to the ownership and operations of our properties. In our opinion, the liabilities, if any, which may ultimately result from such legal actions, will not have a material adverse effect on our financial position, results of operations or cash flows. In the normal course of business, from time to time we incur environmental obligations relating to the ownership and operation of our properties. In our opinion, the liabilities, if any, which may ultimately result from such environmental obligations, will not have a material adverse effect on our financial position, results of operations or cash flows.

12. Segment Information

We operate in three business segments real estate, retail home sales, and finance and insurance. A summary of our business segment information is shown below (in thousands):

	Three Months Ended June 30, 2006 (as restated)		Six Months Ended June 30, 2006 (as restated)	
	2006	2005	2006	2005
Total revenue				
Real estate	\$ 58,139	\$ 51,636	\$ 115,336	\$ 102,808
Retail home sales	2,993	16,394	5,681	23,859
Finance and insurance	335	257	684	357
	61,467	68,287	121,701	127,024
Operating expenses, cost of manufactured homes sold and real estate taxes				
Real estate	21,280	22,163	42,838	44,371
Retail home sales	4,743	17,243	8,240	27,571
Finance and insurance	652	973	1,362	1,363
	26,675	40,379	52,440	73,305
Net segment income (a)				
Real estate	36,859	29,473	72,498	58,437
Retail home sales	(1,750)	(849)	(2,559)	(3,712)
Finance and insurance	(317)	(716)	(678)	(1,006)
	34,792	27,908	69,261	53,719
Property management expense	1,586	2,366	3,178	4,513
General and administrative expense	4,991	6,389	9,412	11,883
Interest expense				
Real estate	16,575	13,963	33,340	27,404
Retail home sales	145	630	417	991
Corporate and other	3,286	2,443	5,830	4,329
	20,006	17,036	39,587	32,724
Amortization expense	1,401	1,234	2,796	2,768
Depreciation expense				
Real estate	20,305	17,403	40,423	32,039
Retail home sales	20	9	20	15
Finance and insurance		2	1	3
Corporate and other	49	114	146	232
	20,374	17,528	40,590	32,289

(a) Net segment income represents total revenues less expenses for property operations, real estate taxes, cost of manufactured homes sold and retail home sales, finance, insurance and other operations. Net segment income is a measure of the performance of the properties before the effects of the following expenses: property management, general and administrative, depreciation, amortization, interest expense and the effect of discontinued operations.

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	Three Months Ended June 30, 2006 (as restated)		Six Months Ended June 30, 2006 (as restated)		2005	
Loss on sale of airplane			541			
Net consumer finance interest expense		204			650	
Interest income	(448)	) (269)	(871)	) (641)		
Loss from continuing operations before income tax benefit and allocation to minority interest	(13,118)	) (16,580)	(25,972)	) (30,467)		
Income tax benefit from continuing operations	3,372		4,571			
Loss from continuing operations before minority interest	(9,746)	) (16,580)	(21,401)	) (30,467)		
Minority interest	166	628	402	1,172		
Loss from continuing operations	(9,580)	) (15,952)	(20,999)	) (29,295)		
Income from discontinued operations	689	302	2,381	1,083		
Gain (loss) on sale of discontinued operations	15,613	52	25,909	(678)		
Income tax expense from discontinued operations	(6,521)	)	(11,316))		
Minority interest in discontinued operations	(343)	) (17)	(596)	) (19)		
Net loss	(142)	) (15,615)	(4,621)	) (28,909)		
Preferred stock dividend	(2,578)	) (2,578)	(5,156)	) (5,156)		
Net loss attributable to common stockholders	\$ (2,720)	) \$ (18,193)	) \$ (9,777)	) \$ (34,065)		

	June 30, 2006	December 31, 2005
Identifiable assets		
Real estate	\$ 1,534,695	\$ 1,642,214
Retail home sales	14,083	28,843
Finance and insurance	27,752	27,689
Corporate and other	24,009	29,735
	\$ 1,600,539	\$ 1,728,481
Notes payable		
Real estate	\$ 913,228	\$ 984,881
Retail home sales	4,513	14,188
Finance and insurance	19,345	18,607
Corporate and other	126,108	128,655
	\$ 1,063,194	\$ 1,146,331

13. Income Taxes

At June 30, 2006, the Company has net operating loss carry-forwards for Federal income tax purposes, subject to certain limitations, of approximately \$348 million and \$332 million for regular income tax and alternative minimum tax, respectively. These net operating loss carry-forwards expire in 2018 through 2025. Losses from continuing operations during the quarter and six months only partially offset the regular taxable earnings from discontinued operations for the quarter and six months ending June 30, 2006 due to the allocation of intra-period taxes as discussed below. The net operating loss carry-forwards for alternative minimum Federal income taxes generally are limited to offsetting 90% of the alternative minimum taxable earnings for a given period.

Based on our estimated composite Federal and state tax rate of 40%, we recorded as of June 30, 2006, a deferred tax asset of approximately \$148.5 million less a valuation allowance reserve of approximately \$74.3 million and deferred tax liabilities of approximately \$74.2 million. We could experience circumstances in the future that result in a non-cash income tax benefit based on the timing of recognition of the tax benefit of our operating losses carried forward from prior years. Under current IRS rules, we can elect to return to REIT status after five years. There can be no assurances that the tax laws and regulations will not change or that we will change our REIT election status in five years.

The Company does not expect to have aggregate income tax benefits or expense for the year ended December 31, 2006. We allocate income taxes between continuing and discontinued operations in accordance with Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* (SFAS No. 109), particularly paragraph 140. We recognize income tax benefits in continuing operations on the effective rate method and income tax expense in discontinued operations without such pro-ration in accordance with Accounting Principles Bulletin 28, *Interim Financial Reporting* (APB 28) and FASB Interpretations 18, *Accounting for Income Taxes in Interim Periods - An interpretation of APB Opinion No. 28* (FIN 18).

The following is a detail of the significant components of the provision for income taxes and a reconciliation of the provision for income taxes to the amount that would be computed by applying the statutory Federal income tax rate of 35% to income before income taxes for the three and six months ended June 30, 2006 (in thousands):

	Three Months Ended June 30, 2006		
	Continuing Operations (as restated)	Discontinued Operations (as restated)	Total (as restated)
Current tax expense	\$	\$	\$
Deferred tax expense			
Intra-period tax benefit (expense)	3,372	(6,521)	(3,149)
Provision for income taxes	\$ 3,372	\$ (6,521)	\$ (3,149)
Tax at statutory rate	\$ 4,492	\$ (5,506)	\$ (1,014)
Permanent differences	107	(228)	(121)
State taxes	642	(787)	(145)
Intra-period tax limitation	(3,075)		(3,075)
Decrease in valuation allowance	1,206		1,206
Provision for income taxes	\$ 3,372	\$ (6,521)	\$ (3,149)

	Six Months Ended June 30, 2006		
	Continuing Operations (as restated)	Discontinued Operations (as restated)	Total (as restated)
Current tax expense	\$	\$	\$
Deferred tax expense			
Intra-period tax benefit (expense)	4,571	(11,316)	(6,745)
Provision for income taxes	\$ 4,571	\$ (11,316)	\$ (6,745)
Tax at statutory rate	\$ 8,893	\$ (9,558)	\$ (665)
Permanent differences	(453)	(392)	(845)
State taxes	1,271	(1,366)	(95)
Intra-period tax limitation	(6,300)		(6,300)
Decrease in valuation allowance	1,160		1,160
Provision for income taxes	\$ 4,571	\$ (11,316)	\$ (6,745)

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amount of the assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The tax effects of significant temporary differences that give rise to the net deferred tax assets and liabilities are as follows (in thousands):

	June 30, 2006	January 1, 2006
Deferred Tax Assets		
Net operating loss carryforwards	\$ 139,262	\$ 146,005
Prepaid rent	276	343
Loan loss reserve	722	373
Allowance for doubtful accounts	498	669
Tax basis goodwill	3,892	4,178
Notes payable	2,010	2,202
Accrued liabilities	1,130	990
Other	231	502
Alternative minimum tax credit	445	
Valuation allowance	(74,270)	(75,430)
Total gross deferred tax assets	\$ 74,196	\$ 79,832
Deferred Tax Liabilities		
Rental and other property, net	\$ 69,800	\$ 73,814
Lease intangibles and customer relationships	3,786	5,176
Deferred commissions.	610	842
Total gross deferred tax liabilities	\$ 74,196	\$ 79,832

14. Subsequent Events

Stockholder Rights Plan

On July 11, 2006, we entered into a Stockholder Rights Plan (the Rights Plan) under which one right was distributed as a dividend for each share of our common stock held by stockholders of record as of the close of business on July 17, 2006. The Rights Plan has been adopted as a means to preserve the use of previously accumulated net operating losses, as described below. Effective with the revocation of our REIT election in March 2006, we have been taxed as a corporation for U.S. Federal income tax purposes and our net income has been subject to taxation at regular (or alternative minimum) corporate rates without the benefit of a dividends paid deduction. We have net operating losses (NOLs) from prior years that are expected to offset substantially our taxable income, if any. Therefore, the preservation of such NOLs is the key to minimizing our U.S. Federal income tax liability. U.S. Federal income tax law imposes significant limitations on the ability of a corporation to use its NOLs to offset income in circumstances where such corporation has experienced a change in ownership. Generally, there is a change in ownership if, at any time, one or more 5% shareholders have aggregate increases in their ownership in the corporation of more than 50 percentage points looking back over the prior three year period. One of the principal reasons for adopting the Rights Plan is to preserve the use of the NOLs by dissuading investors from aggregating ownership in ARC and triggering such a change in ownership. The Rights Plan is designed to reduce the likelihood of a change in ownership by, among other things, discouraging any person or group from acquiring additional shares such that they would beneficially own 5% or more of the outstanding shares of our common stock. The Rights Plan was not adopted in response to any effort to acquire control of the Company. To help preserve the benefit of the NOLs, we intend to submit for stockholder approval an amendment to our charter to restrict certain acquisitions of our common stock so as to reduce the likelihood of triggering a change in ownership. The Board of Directors intends to terminate the Rights Plan if the charter amendment is approved. Under the Rights Plan, each right initially will entitle stockholders to purchase a fraction of a share of preferred stock at a purchase price of \$50.00, subject to adjustment as provided in the Rights Plan. Subject to the exceptions and limitations contained in the Rights Plan, the rights generally will be exercisable only if a person or group acquires beneficial ownership of 5% or more of our common stock or commences a tender or exchange offer upon consummation of which such person or group would beneficially own 5% or more of our common stock. Unless earlier terminated, the rights will expire on July 17, 2016.

Refinancing

On July 11, 2006, six indirect wholly owned subsidiaries of the Company, as co-borrowers, entered into a \$230 million mortgage debt facility with Merrill Lynch Mortgage Lending, Inc. Approximately \$175 million of the proceeds of the loan were used to repay other debt. The loan agreement is comprised of two components; a \$170 million 10-year fixed rate mortgage debt component and a \$60 million 3-year floating rate mortgage debt component with two one-year (no-fee) extension options. The fixed rate component bears interest at 6.239% and requires interest-only payments for the term of the loan. The floating rate component is adjusted monthly, bears interest at one-month LIBOR plus 80 basis points and requires interest-only payments for the term of the loan. The loan is secured by 59 manufactured housing communities located in 18 states as well as an assignment of leases and rents associated with the mortgaged property. The loan is non-recourse with the exception that the repayment of the indebtedness is guaranteed pursuant to a guaranty of non-recourse obligations in the event of declaration of bankruptcy; interference with any of the lenders rights, and asset transfers and other activities in violation of the loan documents. Under the provisions of the loan agreement, we have the right to prepay any portion of the floating rate component, with or without release of the mortgaged property, without penalty. Subsequent to a prepayment of the entire floating rate component of the loan, we have the option to prepay a fixed portion of the loan subject to prepayment fees, yield maintenance or defeasance in accordance with the terms of the loan agreement.

Stock Option Grants

On July 27, 2006, the Compensation Committee of our Board of Directors approved the grant of non-qualified stock option awards to certain senior executive officers of the Company pursuant to our 2003 Equity Incentive Plan. Larry D. Willard, Chairman and Chief Executive Officer, was granted options to purchase up to 200,000 shares; James Kimsey, President and Chief Operating Officer, was granted options to purchase up to 140,000 shares; Lawrence R. Kreider, Executive Vice President and Chief Financial Officer, was granted options to purchase up to 80,000 shares; and Scott L. Gesell, Executive Vice President and General Counsel, was granted options to purchase up to 80,000 shares, in each case at an exercise price of \$10.74, the closing price of ARC's common stock on the New York Stock Exchange on the date of grant. The options have a term of ten years from the date of the award. Under the terms of the grants, the options vest ratably over a three-year period with the first third of the award amount vesting on the first anniversary of the award, the second third vesting on the second anniversary date of the award, and the balance vesting on the third anniversary date of the award. Vesting is accelerated in certain circumstances, including in the event of the death of the award recipient or in the event of a change of control of the Company.

Redemption of Series C PPU's

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In January 2007, all 705,688 units of our Series C PPU were redeemed according to their terms for 1,628,410 shares of ARC common stock.

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Acquisition of NLASCO, Inc.

On January 31, 2007, we acquired all of the stock of NLASCO, Inc. (NLASCO), a privately held property and casualty insurance holding company, and its subsidiaries. In exchange for the stock, NLASCO s shareholders, consisting of C. Clifton Robinson and affiliates, received \$105.75 million in cash and 1,218,880 shares of ARC common stock for a total consideration of \$117.5 million. In addition, Flexpoint Fund, L.P., a fund managed by Flexpoint Partners, LLC of Chicago, Illinois, invested \$20 million to purchase 2,154,763 shares of common stock of the Company at the leading ten-day average market price of our common stock on the date the agreement was signed, subject to certain anti-dilution provisions. The acquisition closed on January 31, 2007.

In order to raise \$80 million to provide a source of funding for a portion of the acquisition of NLASCO, we conducted a rights offering to our stockholders. In the rights offering, all holders of ARC common stock as of the record date of December 19, 2006 received one non-transferable right to purchase approximately 0.242 shares of common stock of the Company for each share held. The price at which the additional shares were purchased was \$8.00 per share. The rights offering expired on January 23, 2007, and the company issued approximately 7.8 million shares of common stock to existing shareholders on that date. In addition, Gerald J. Ford and certain affiliates controlled by him purchased approximately 1.8 million shares that they would have been entitled to in the rights offering in a separate private placement transaction. Gerald J. Ford, one of the Company s directors and the beneficial owner of approximately 17.6% of ARC s common stock as of the record date, and certain of his affiliates also backstopped the rights offering and purchased another approximately 400,000 shares that were not purchased in the rights offering by the stockholders of record on the record date, at the rights offering price per share of \$8.00.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the consolidated historical financial statements and notes appearing elsewhere in this Form 10-Q/A and the financial information set forth in the tables below.

FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q/A includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, as amended by the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical facts, included in this report that address results or developments that we expect or anticipate will or may occur in the future, where statements are preceded by, followed by or include the words believes, expects, may, will, would, could, should, may, seeks, approximately, intends, plans, projects, estimates or anticipates or the negative of these words and phrases or similar words or phrases, including such things as our business strategy, our ability to obtain future financing arrangements, estimates relating to our future distributions, our understanding of our competition, market trends, projected capital expenditures, the impact of technology on our products, operations and business, are forward-looking statements. The forward-looking statements are based on our beliefs, assumptions and expectations of our future performance taking into account all information currently available to us. These beliefs, assumptions and expectations are subject to risks and uncertainties and can change as a result of many possible events or factors, not all of which are known to us. If a change occurs, our business, business plan, financial condition, liquidity and results of operations may vary materially from those expressed in our forward-looking statements. These risks could cause actual results to vary materially from our forward-looking statements along with the risks disclosed in the section of this report entitled Risk Factors and the following factors:

- competition from other forms of single or multifamily housing;
- changes in market rental rates, supply and demand for affordable housing, the cost of acquiring, transporting, setting or selling manufactured homes;
- the availability of manufactured homes from manufacturers;
- the availability of cash or financing for us to acquire additional manufactured homes;
- the ability of manufactured home buyers to obtain financing;
- our ability to maintain or increase rental rates and maintain or improve occupancy;
- the level of repossessions by manufactured home lenders;
- the adverse impact of external factors such as changes in interest rates, inflation and consumer confidence;
- the ability to identify acquisitions, have funds available for acquisitions, the pace of acquisitions and/or dispositions of communities and new or rental homes;
- our corporate debt ratings;
- demand for home purchases in our communities and demand for financing of such purchases;
- demand for rental homes in our communities;
- the condition of capital markets;
- actual outcome of the resolution of any conflict;
- our ability to successfully operate acquired properties;

- our decision and ability to sell additional communities and the terms and conditions of any such sales and whether any such sales actually close;
- issues arising from our decision not to continue to maintain our status as a real estate investment trust (REIT) ;
- the impact of the tax code and rules on our balance sheet and business operations;
- our ability to pay dividends or make other distributions to our stockholders and the Partnership s unitholders;
- environmental uncertainties and risks related to natural disasters;
- changes in and compliance with real estate permitting, licensing and zoning laws including legislation affecting monthly leases and rent control and increases in property taxes; and
- changes in and compliance with licensing requirements regarding the sale or leasing of manufactured homes.

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Consequently, all of the forward-looking statements made in this report are qualified by these cautionary statements and there can be no assurance that the actual results or developments anticipated by us will be realized, or even substantially realized, and that they will have the expected consequences to or effects on us and our business or operations. Forward-looking statements made in this report speak as of the date hereof or as of the date specifically referenced in any such statement set forth herein. We undertake no obligation to update or revise any forward-looking statements in this report.

GENERAL STRUCTURE OF THE COMPANY

We are a fully integrated, self-administered and self-managed corporation focused on the operation of primarily all-age manufactured home communities. We also conduct certain complementary business activities focused on improving and maintaining occupancy in our communities, including the rental of manufactured homes, the retail sale of manufactured homes, the financing of sales of manufactured homes and acting as agent in the sale of homeowners insurance and other related insurance products. We conduct substantially all of our activities through our Operating Partnership (OP), of which we are the sole general partner and in which we hold a 96.5% ownership interest as of June 30, 2006.

Beginning in 1995 our predecessors founded several companies under the name Affordable Residential Communities or ARC for the purpose of engaging in the business of acquiring, renovating, repositioning and operating manufactured home communities, as well as certain related businesses. We were formed in July 1998 as a Maryland corporation for the purpose of acting as the investment vehicle for and a co-general partner of our OP, the fourth real property partnership organized and operated by our co-founders. In May 2002, we completed a reorganization in which we acquired substantially all the other real property partnerships and other related businesses organized and operated by our predecessors and became the sole general partner of our OP.

RESTATEMENT

On March 8, 2007, the Audit Committee of the Board of Directors of Affordable Residential Communities Inc. (the Company) determined that the Company should restate its unaudited consolidated financial statements as of and for the quarterly periods ended March 31, 2006, June 30, 2006 and September 30, 2006, to correct the allocation of income taxes (intra-period tax allocation) between continuing operations and discontinued operations for the first three quarters of 2006, as more fully described below. The Company does not expect any aggregate income tax expense or benefit for the year ended December 31, 2006. The above corrections do not have an adverse impact on any covenants associated with the Company's debt facilities.

Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* (SFAS 109), requires that a company with a loss from continuing operations consider all items reported apart from continuing operations (for example extraordinary items, discontinued operations and other comprehensive income) in determining the tax benefit that results from a loss from continuing operations. In our case, because we had a loss from continuing operations and a gain from discontinued operations in each of the periods referenced above, in accordance with SFAS 109 and Emerging Issues Task Force Topic D32, *Intra-period Tax Allocation of the Tax Effect of Pre-Tax Income from Continuing Operations*, we should have considered the gain from discontinued operations in determining the amount of tax benefit to allocate to continuing operations. However, we originally determined the allocation of income taxes (intra-period allocation) between continuing and discontinued operations using a with and without methodology. That is, we did not believe that a tax benefit resulted from the loss from continuing operations because we did not believe there was an incremental benefit from the loss generated from our continuing operations. Additionally, we believed that the gain from discontinued operations did not attract a tax consequence.

In accordance with FASB Interpretation No. 18, *Accounting for Income Taxes in Interim Periods - An Interpretation of APB Opinion No. 28*, the tax benefit recognized in continuing operations is calculated using an effective rate methodology and therefore will be provided for over the course of the year. The tax expense recognized in discontinued operations is recognized on a discrete basis and therefore the entire amount of tax expense is recognized at the time the pretax gain on the discontinued operations is recognized. This mismatch in the timing of the recognition of tax benefits and expense resulted in a restatement of the net loss for the quarter and six months ended June 30, 2006.

RECENT DEVELOPMENTS

In the first six months of 2006, the Company closed on 36 previously contracted community sales transactions comprising \$77.0 million of cash proceeds net of related debt, defeasance and other closing costs of \$59.6 million. We expect to close the remaining sales transaction 2007 and will continue to own and operate these communities through the date of sale. There can be no assurance, however, that the Company will close all of the remaining community sales, or, if they close, that they will close on the terms set forth in the contract with respect to each.

On June 8, 2006, the board of directors declared a quarterly cash dividend of \$0.515625 per share for our Series A Cumulative Redeemable Preferred Stock, and \$0.39 per unit on the Series C Preferred Operating Partnership Units of the OP. The dividends were paid on July 28, 2006 to shareholders of record on July 14, 2006. The Board reviews the payment of dividends on a quarterly basis.

On July 11, 2006 we entered into a Stockholder Rights Plan (the Rights Plan) under which one right was distributed as a dividend for each share of our common stock held by stockholders of record as of the close of business on July 17, 2006. The Rights Plan has been adopted as a means to preserve the use of previously accumulated net operating losses, as described below. Effective with the revocation of our REIT election in March 2006, we have been taxed as a corporation for U.S. Federal income tax purposes and our net income has been subject to taxation at regular (or alternative minimum) corporate rates without the benefit of a dividends paid deduction. We have net operating losses (NOLs) from prior years that are expected to offset substantially our taxable income, if any. Therefore, the preservation of such NOLs is the key to minimizing our U.S. Federal income tax liability. U.S. Federal income tax law imposes significant limitations on the ability of a corporation to use its NOLs to offset income in circumstances where such corporation has experienced a change in ownership. Generally, there is a change in ownership if, at any time, one or more 5% shareholders have aggregate increases in their ownership in the corporation of more than 50 percentage points looking back over the prior three year period. One of the principal reasons for adopting the Rights Plan is to preserve the use of the NOLs by dissuading investors from aggregating ownership in ARC and triggering such a change in ownership. The Rights Plan is designed to reduce the likelihood of a change in ownership by, among other things, discouraging any person or group from acquiring additional shares such that they would beneficially own 5% or more of the outstanding shares of our common stock. The Rights Plan was not adopted in response to any effort to acquire control of the Company. To help preserve the benefit of the NOLs, we intend to submit for stockholder approval an amendment to our charter to restrict certain acquisitions of our common stock so as to reduce the likelihood of triggering a change in ownership. The Board of Directors intends to terminate the Rights Plan if the charter amendment is approved. Under the Rights Plan, each right initially will entitle stockholders to purchase a fraction of a share of preferred stock at a purchase price of \$50.00, subject to adjustment as provided in the Rights Plan. Subject to the exceptions and limitations contained in the Rights Plan, the rights generally will be exercisable only if a person or group acquires beneficial ownership of 5% or more of our common stock or commences a tender or exchange offer upon consummation of which such person or group would beneficially own 5% or more of our common stock. Unless earlier terminated, the rights will expire on July 17, 2016.

On July 11, 2006, six indirect wholly owned subsidiaries of the Company, as co-borrowers, entered into a \$230 million mortgage debt facility with Merrill Lynch Mortgage Lending, Inc. Approximately \$175 million of the proceeds of the loan were used to repay other debt. The loan agreement is comprised of two components; a \$170 million 10-year fixed rate mortgage debt component and a \$60 million 3-year floating rate mortgage debt component with two one-year (no-fee) extension options. The fixed rate component bears interest at 6.239% and requires interest-only payments for the term of the loan. The floating rate component is adjusted monthly, bears interest at one-month LIBOR plus 80 basis points and requires interest-only payments for the term of the loan. The loan is secured by 59 manufactured housing communities located in 18 states as well as an assignment of leases and rents associated with the mortgaged property. The loan is non-recourse with the exception that the repayment of the indebtedness is guaranteed pursuant to a guaranty of non-recourse obligations in the event of declaration of bankruptcy; interference with any of the lenders rights, and asset transfers and other activities in violation of the loan documents. Under the provisions of the loan agreement, we have the right to prepay any portion of the floating rate component, with or without release of the mortgaged property, without penalty. Subsequent to a prepayment of the entire floating rate component of the loan, we have the option to prepay a fixed portion of the loan subject to prepayment fees, yield maintenance or defeasance in accordance with the

terms of the loan agreement.

On July 27, 2006, the Compensation Committee of our Board of Directors approved the grant of non-qualified stock option awards to certain senior executive officers of the Company pursuant to our 2003 Equity Incentive Plan. Larry D. Willard, Chairman and Chief Executive Officer, was granted options to purchase up to 200,000 shares; James Kimsey, President and Chief Operating Officer, was granted options to purchase up to 140,000 shares; Lawrence R. Kreider, Executive Vice President and Chief Financial Officer, was granted options to purchase up to 80,000 shares; and Scott L. Gesell, Executive Vice President and General Counsel, was granted options to purchase up to 80,000 shares, in each case at an exercise price of \$10.74, the closing price of ARC's common stock on the New York Stock Exchange on the date of grant. The options have a term of ten years from the date of the award. Under the terms of the grants, the options vest ratably over a three-year period with the first third of the award amount vesting on the first anniversary of the award, the second third vesting on the second anniversary date of the award, and the balance vesting on the third anniversary date of the award. Vesting is accelerated in certain circumstances, including in the event of the death of the award recipient or in the event of a change of control of the Company.

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OVERVIEW OF RESULTS

For the three and six months ended June 30, 2006, net loss attributable to common stockholders was (\$2.7) million (as restated) and (\$9.8) million (as restated), or (\$0.06) per share (as restated) and (\$0.22) per share (as restated), respectively, as compared to net losses attributable to common stockholders of (\$18.2) million and (\$34.1) million, or (\$0.42) per share and (\$0.79) per share, for the same periods in 2005. Revenue in our real estate segment increased to \$58.1 million for the three months ended June 30, 2006 as compared to \$51.6 million for the same period in 2005. Real estate segment expenses for the three months ended June 30, 2006 decreased to \$21.3 million, as compared with \$22.2 million for the three months ended June 30, 2005. As a result, real estate net segment income increased to \$36.9 million for the three months ended June 30, 2006 as compared to \$29.5 million for the same period in 2005. See Real Estate Net Segment Income included hereinafter in this section for definitions of real estate net segment income and for reconciliations of real estate net segment income to net loss, the most directly comparable GAAP measure.

Total portfolio occupancy averaged 83.5% for the three and six months ended June 30, 2006 and averaged 82.8% and 82.3% for the three and six months ended June 30, 2005, respectively. The following table summarizes our occupancy net activity for the three and six months ended June 30:

The following table summarizes our occupancy net activity for the three and six months ended June 30:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Homeowner activity:				
Homeowner move ins	277	135	530	385
Homeowner move outs	(540)	(740)	(1,088)	(1,428)
Home sales	130	902	262	1,641
Repossession move outs	(358)	(449)	(661)	(1,051)
Net homeowner activity	(491)	(152)	(957)	(453)
Home renter activity:				
Home renter move ins	945	1,026	1,872	1,864
Home renter lease with option to purchase move ins	403	1,189	792	1,982
Home renter move outs	(944)	(1,279)	(1,799)	(2,321)
Net home renter activity	404	936	865	1,525
Net activity	(87)	784	(92)	1,072
The following reconciles the above activity to the period end occupied homesites.				
Net homeowner activity	(491)	(152)	(957)	(453)
Occupied homeowner sites, beginning of period	39,943	41,535	40,409	41,836
Occupied homeowner sites, end of period	39,452	41,383	39,452	41,383
Net home renter activity	404	936	865	1,525
Occupied home renter sites, beginning of period	7,929	5,978	7,468	5,389
Occupied home renter sites, end of period	8,333	6,914	8,333	6,914
Total occupied homesites, end of period	47,785	48,297	47,785	48,297
Total occupancy percentage (a)	83.5 %	84.3 %	83.5 %	84.3 %

(a) The Company removed a net 603 lots from its homesite count from December 31, 2004 to June 30, 2006 as part of its ongoing review of operations.

On June 30, 2006, our total home inventory was 9,409 homes. Results in the three and six months ended June 30, 2006, as compared with the same periods in 2005, reflect a change in sales and marketing programs that we implemented in the fourth quarter of 2005 to increase the sales pricing of our homes. We continue to focus on affordable price points, marketing, training of our employees and the

availability of chattel financing through our consumer finance program. In the three months ended June 30, 2006, we sold 130 manufactured homes from our home inventory, compared with 902 for the same period in 2005.

BUSINESS OBJECTIVES, PROPERTY MANAGEMENT AND OPERATING STRATEGIES

Community and General Business Management. We are currently focused on community operations. Historically, we focused more extensively on community acquisition opportunities. Our principal business objectives are to achieve sustainable long-term growth in cash flow and to maximize returns to our investors. Generally we provide a clean, attractive and affordable place for our residents to live that is competitive with other forms of housing and provide real value and service to our residents. We have established district and regional management that has a sufficiently limited span of control to allow for adequate focus on community operations. We operate against a detailed, bottom-up, budget against which we regularly compare our results throughout the year. In our community operations, we are focused on rent levels, recovery of utility costs and control of expenses. In our marketing programs, we are focused on profitable programs in the sale and leasing of homes. We implemented procedures to increase the pricing of our home and leasing transactions. Our primary tools remain (i) our rental home program, including our lease with option to purchase program, (ii) our for-sale inventory and (iii) our consumer finance program. We took steps to down-size our sales and marketing organization in the fourth quarter of 2005 and terminated over 150 employees, primarily in sales management. Our other key operating objectives include the following:

Customer Satisfaction and Quality Control. Our goal is to meet the needs of our residents or prospective residents for housing alternatives in a clean and attractive environment at affordable prices. We approach our business with a consumer product focus having an emphasis on value and quality to our residents and prospective residents. We have quality assurance programs executed through employee training and adherence to guidelines developed by our senior management, based in part upon surveys of our customers. Our customer focus and quality controls are designed to provide consistency and quality of product and to enable our community managers to effectively market our communities and improve resident satisfaction and retention across our portfolio.

Presence in Key Markets. As of June 30, 2006, approximately 74% of our homesites are located in our 20 largest markets. We believe we have a leading market share in 15 of these markets, based on number of homesites. A significant market share should enable us to (i) achieve operating efficiencies and economies of scale by leveraging our local property management infrastructure and other operating overhead over a larger number of communities and homesites, (ii) provide potential residents with a broader range of affordable housing options in their market, (iii) increase our visibility and brand recognition and leverage advertising costs and (iv) obtain more favorable terms and faster turnaround time on construction, renovation, repairs and home installation services. We believe the continuing significant size and geographic diversity of our portfolio reduces our exposure to risks associated with geographic concentration, including the risk of economic downturns or natural disasters in any one market in which we operate.

Management of Occupancy. In response to challenging industry conditions, particularly the shortage of available consumer financing for the purchase of manufactured housing, we have several programs designed to have a favorable impact on occupancy, resident satisfaction and retention, and revenue and operating margins. We focus on converting long-term renters into homeowners and improving occupancy through the sale of older homes for cash, the sale for cash or financing of newer homes and the leasing of newer homes with an option to purchase.

THE PROPERTIES

As of June 30, 2006, our portfolio consisted of 275 manufactured home communities (net of five communities classified as discontinued operations, see Note 10 in the accompanying financial statements) comprising 57,240 homesites located in 23 states and 58 markets, primarily oriented toward all-age living. Our five largest markets are Dallas/Fort Worth, Texas, with 12.5% of our total homesites; Atlanta, Georgia, with 8.7% of our total homesites; Salt Lake City, Utah, with 6.6% of our total homesites; the Front Range of Colorado, with 5.7% of our total homesites; and Kansas City-Lawrence-Topeka, Kansas, with 4.2% of our total homesites.

As of June 30, 2006, our communities had an occupancy rate of 83.5%, and the average monthly rental income per occupied homesite was \$362. Homesite leases by homeowners generally are month-to-month, or in limited cases year-to-year, and require security deposits. In the case of our residents renting homes from us, lease terms are typically one year, and require a security deposit.

The following table sets forth certain information regarding our communities, arranged from our largest to smallest market, as of June 30, 2006:

Markets (1)	Number of Total Homesites	Percentage of Total Homesites	Occupancy 06/30/06	Rental Income Per Occupied Homesite Per Month (2) 06/30/06
Dallas Ft. Worth, TX	7,181	12.5	% 80.2	% \$ 400
Atlanta, GA	4,967	8.7	% 89.2	% 389
Salt Lake City, UT	3,796	6.6	% 93.4	% 368
Front Range of CO	3,290	5.7	% 83.8	% 463
Kansas City Lawrence Topeka, MO KS	2,424	4.2	% 87.4	% 319
Jacksonville, FL	2,259	4.0	% 90.2	% 374
Wichita, KS	2,162	3.9	% 61.9	% 316
St. Louis, MO IL	1,914	3.4	% 79.5	% 323
Oklahoma City, OK	1,891	3.4	% 78.2	% 327
Orlando, FL	1,858	3.2	% 92.9	% 397
Greensboro Winston Salem, NC	1,396	2.4	% 66.0	% 303
Davenport Moline Rock Island, IA IL	1,382	2.4	% 86.5	% 303
Elkhart Goshen, IN	1,209	2.1	% 87.5	% 384
Charleston North Charleston, SC	1,184	2.1	% 81.5	% 309
Raleigh Durham Chapel Hill, NC	1,092	1.9	% 91.5	% 394
Sioux City, IA NE	994	1.7	% 81.2	% 337
Syracuse, NY	939	1.6	% 61.0	% 383
Des Moines, IA	859	1.5	% 88.1	% 359
Flint, MI	838	1.5	% 72.3	% 402
Pueblo, CO	752	1.3	% 65.0	% 334
Subtotal Top 20 Markets	42,387	74.1	% 82.8	% \$ 371
All Other Markets	14,853	25.9	% 85.5	% \$ 337
Total / Weighted Average	57,240	100.0	% 83.5	% \$ 362

(1) Markets are defined by our management.

(2) Rental Income is defined as homeowner rental income, home renter rental income and other rental income reduced by move-in bonuses and rent concessions.

COMMUNITIES

Comparison of the Three and Six Months Ended June 30, 2006 to the Three and Six Months Ended June 30, 2005

The following table presents certain information relative to our real estate segment as of and for the three and six months ended June 30, 2006 and 2005 (in thousands, except home, community and income and revenue per unit information):

	Three Months Ended		Six Months Ended	
	June 30, 2006	2005	June 30, 2006	2005
Average total homesites	57,242	57,694	57,227	57,750
Average total rental homes	9,324	7,789	9,295	7,684
Average occupied homesites - homeowners	39,666	41,454	39,912	41,606
Average occupied homesites - rental homes	8,128	6,293	7,854	5,949
Average total occupied homesites	47,794	47,747	47,766	47,555
Average occupancy - rental homes	87.2	% 80.8	% 84.5	% 77.4
Average occupancy - total	83.5	% 82.8	% 83.5	% 82.3
Real estate revenue				
Homeowner rental income	\$ 36,995	\$ 35,488	\$ 73,860	\$ 71,001
Home renter rental income	14,764	11,036	28,588	21,598
Other	200	310	417	580
Rental income	51,959	46,834	102,865	93,179
Utility and other income	6,180	4,802	12,471	9,629
Total real estate revenue	58,139	51,636	115,336	102,808
Real estate expenses				
Property operations expenses	16,256	18,093	32,678	36,334
Real estate taxes.	5,024	4,070	10,160	8,037
Total real estate expenses	21,280	22,163	42,838	44,371
Real estate net segment income	\$ 36,859	\$ 29,473	\$ 72,498	\$ 58,437
Average monthly rental income per total occupied homesite(1)	\$ 362	\$ 327	\$ 359	\$ 327
Average monthly homeowner rental income per homeowner occupied homesite(2)	\$ 311	\$ 285	\$ 308	\$ 284
Average monthly home renter income per occupied rental home(3)	\$ 605	\$ 585	\$ 607	\$ 605

	June 30, 2006	2005
Total communities	275	275
Total homesites	57,240	57,311
Occupied homesites	47,785	48,297
Total rental homes owned	9,409	8,045
Occupied rental homes	8,333	6,914

(1) Average monthly rental income per total occupied homesite is defined as rental income divided by average total occupied homesites divided by the number of months in the period.

(2) Average monthly homeowner rental income per homeowner occupied homesite is defined as homeowner rental income divided by average homeowner occupied homesites divided by the number of months in the period.

(3) Average monthly home renter rental income per occupied rental home is defined as home renter rental income divided by average occupied rental homes divided by the number of months in the period.

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	Three Months Ended June 30, 2006 (as restated)		Six Months Ended June 30, 2006 (as restated)	
	2006	2005	2006	2005
Net segment income:				
Real estate	\$ 36,859	\$ 29,473	\$ 72,498	\$ 58,437
Retail home sales	(1,750)	(849)	(2,559)	(3,712)
Finance and insurance	(317)	(716)	(678)	(1,006)
	34,792	27,908	69,261	53,719
Other expenses:				
Property management	1,586	2,366	3,178	4,513
General and administrative	4,991	6,389	9,412	11,883
Depreciation and amortization	21,775	18,762	43,386	35,057
Loss on sale of airplane			541	
Net consumer finance interest expense		204		650
Interest expense	20,006	17,036	39,587	32,724
Total other expenses	48,358	44,757	96,104	84,827
Interest income	(448)	(269)	(871)	(641)
Loss from continuing operations before income tax benefit and allocation to minority interest	(13,118)	(16,580)	(25,972)	(30,467)
Income tax benefit from continuing operations	3,372		4,571	
Loss from continuing operations before minority interest	(9,746)	(16,580)	(21,401)	(30,467)
Minority interest	166	628	402	1,172
Loss from continuing operations	(9,580)	(15,952)	(20,999)	(29,295)
Income from discontinued operations	689	302	2,381	1,083
Gain (loss) on sale of discontinued operations	15,613	52	25,909	(678)
Income tax expense from discontinued operations	(6,521)		(11,316)	
Minority interest in discontinued operations	(343)	(17)	(596)	(19)
Net loss	(142)	(15,615)	(4,621)	(28,909)
Preferred stock dividend	(2,578)	(2,578)	(5,156)	(5,156)
Net loss attributable to common stockholders	\$ (2,720)	\$ (18,193)	\$ (9,777)	\$ (34,065)

RESULTS OF OPERATIONS

Comparison of the Three Months Ended June 30, 2006 to the Three Months Ended June 30, 2005

Revenue. Revenue for the three months ended June 30, 2006 was \$61.5 million, as compared to \$68.3 million for the three months ended June 30, 2005, a decrease of \$6.8 million, or 10%. Rental income increased by \$5.1 million, primarily as a result of \$3.6 million from higher home renter rental income and \$3.0 million from increased rental rates, partially offset by \$1.5 million from decreased homeowner occupancy. Revenue from the sale of manufactured homes decreased by \$13.4 million as the Company sold 772 fewer homes in the second quarter of 2006, as compared to the same quarter last year. We implemented a change in sales and marketing programs in the fourth quarter of 2005 to increase the sales pricing of our homes. Utility and other income increased by \$1.2 million due to increases in utilities expense and our increased focus on utility recovery.

Property Operations Expense. For the three months ended June 30, 2006, total property operations expense was \$16.3 million, as compared to \$18.1 million for the three months ended June 30, 2005, a decrease of \$1.8 million, or 10%. The decrease primarily is due to decreases in: a) salaries and benefits of \$1.4 million, or 22%, from decreased headcount; b) repairs and maintenance of \$0.3 million, or 13%; c) bad debt expense of \$0.2 million, or 40%; and d) other expenses of \$0.7 million. These decreases partially were offset by an increase in utilities and telephone expense of \$0.8 million.

Real Estate Taxes Expense. Real estate taxes expense for the three months ended June 30, 2006 was \$5.0 million, as compared to \$4.0 million for the three months ended June 30, 2005, an increase of \$1.0 million or 23%. The increase primarily is due to higher property tax assessments. A portion of the increase also relates to a higher number of manufactured homes subject to property tax assessments in the current year.

Cost of Manufactured Homes Sold. The cost of manufactured homes sold, including sales commissions, was \$2.6 million, or \$19,700 per unit, for the three months ended June 30, 2006, as compared to \$14.7 million, or \$16,300 per unit, for the three months ended June 30, 2005, a decrease of \$12.1 million. The decrease primarily was due to the decrease in the number of manufactured homes sold, as discussed above. The Company recorded a net gain on the sale of manufactured homes of \$0.4 million and \$1.7 million, respectively, in the quarters ended June 30, 2006 and 2005.

Retail Home Sales, Finance and Insurance Expense. For the three months ended June 30, 2006, total retail home sales, finance and insurance expense was \$2.8 million as compared to \$3.5 million for three months ended June 30, 2005, a decrease of \$0.7 million. This decrease primarily is due to the down-sizing of our sales and marketing organization in which we terminated over 150 employees in the fourth quarter of 2005, primarily in sales management.

Property Management Expense. Property management expense for the three months ended June 30, 2006 was \$1.6 million, as compared to \$2.4 million for the three months ended June 30, 2005, a decrease of \$0.8 million, or 33%. The decrease primarily is due to reduced advertising expenses and headcount reductions resulting in lower salaries and benefits and travel expenses.

General and Administrative Expense. General and administrative expense for the three months ended June 30, 2006 was \$5.0 million, as compared to \$6.4 million for the three months ended June 30, 2005, a decrease of \$1.4 million, or 22%. The decrease primarily was due to lower salaries and benefits and the related travel expenses, as well as a reduction in professional services resulting from Sarbanes-Oxley implementation costs incurred last year.

Depreciation and Amortization Expense. Depreciation and amortization expense for the three months ended June 30, 2006 was \$21.8 million, as compared to \$18.8 million for the three months ended June 30, 2005, an increase of \$3.0 million, or 16%. The increase primarily is due to depreciation on the significant amount of mobile homes and community improvements placed in service during the latter half of 2005.

Interest Expense. Interest expense for the three months ended June 30, 2006 was \$20.0 million, as compared to \$17.0 million for the three months ended June 30, 2005, an increase of \$3.0 million, or 17%. The increase is due to a higher outstanding average debt balance of approximately \$87 million, as well as higher effective weighted average interest rates on our variable rate debt.

Income Taxes. The Company expects to have no aggregate income tax expense or benefit for the year ended December 31, 2006. However, we have restated our Consolidated Financial Statements for the three months ended June 30, 2006 to (a) provide for an intra-period income tax allocation whereby we recorded an income tax benefit from continuing operations of \$3.4 million (as restated) (including \$1.2 million (as restated) deferred from the first quarter) and an income tax expense from discontinued operations of \$6.5 million (as restated) in accordance with SFAS No. 109 and (b) deferred the resulting income tax benefit from continuing operations to future interim periods using an estimated annual effective tax rate in accordance with APB 28 and FIN 18.

Minority Interest. Minority interest for the three months ended June 30, 2006 was \$0.2 million (as restated) as compared to \$0.6 million for the three months ended June 30, 2005, a decrease of \$0.4 million, or 74%. The decrease primarily was due to a decrease in the minority interest share of our net loss to 3.5% from 5.2% for the second quarter of 2005.

Discontinued Operations. On December 15, 2005, the Company held an auction in which it offered 71 communities for sale. The Company ultimately entered into contracts to sell 38 of these communities. During 2006, the Company entered into contracts to sell another three communities. During the second quarter of 2006, the Company closed nine of these transactions, comprising \$42.8 million of cash proceeds net of related debt, defeasance and other closing costs

of \$25.3 million. A gain of \$15.6 million was recorded on the sales of these communities in the second quarter of 2006.

Preferred Stock Dividend. On June 8, 2006, the ARC board of directors declared a quarterly cash dividend of \$0.5156 per share for each of the 5,000,000 outstanding shares of our Series A Preferred Stock. This dividend, which was paid on July 28, 2006, amounted to \$2.6 million. For the quarter ended June 30, 2005, the dividend declared also was \$0.5156 per share, or \$2.6 million.

Net Loss Attributable to Common Stockholders. As a result of the foregoing, our net loss attributable to common stockholders was (\$2.7) million (as restated) for the three months ended June 30, 2006, as compared to a net loss attributable to common stockholders of (\$18.2) million for the three months ended June 30, 2005, a reduction in net loss of \$15.5 million or 85%.

Comparison of the Six Months Ended June 30, 2006 to the Six Months Ended June 30, 2005

Revenue. Revenue for the six months ended June 30, 2006 was \$121.7 million, as compared to \$127.0 million for the six months ended June 30, 2005, a decrease of \$5.3 million, or 4%. Rental income increased by \$9.7 million, primarily as a result of \$6.8 million from higher home renter rental income and \$5.8 million from increased rental rates, partially offset by \$2.9 million from decreased homeowner occupancy. Revenue from the sale of manufactured homes decreased by \$18.2 million as the Company sold 1,379 fewer homes in the first six months of 2006, as compared to the same period last year. We implemented a change in sales and marketing programs in the fourth quarter of 2005 to increase the sales pricing of our homes. Utility and other income increased by \$2.8 million due to increases in utilities expense and our increased focus on utility recovery.

Property Operations Expense. For the six months ended June 30, 2006, total property operations expense was \$32.7 million, as compared to \$36.3 million for the six months ended June 30, 2005, a decrease of \$3.6 million, or 10%. The decrease primarily is due to decreases in: a) salaries and benefits of \$1.9 million, or 16%, from decreased headcount; b) repairs and maintenance of \$0.9 million, or 19%; c) bad debt expense of \$0.5 million, or 41%; and d) other expense of \$1.2 million. These decreases partially were offset by an increase in utilities and telephone expense of \$0.9 million.

Real Estate Taxes Expense. Real estate taxes expense for the six months ended June 30, 2006 was \$10.2 million, as compared to \$8.0 million for the six months ended June 30, 2005, an increase of \$2.2 million or 26%. The increase primarily is due to higher property tax assessments. A portion of the increase also relates to a higher number of manufactured homes subject to property tax assessments in the current year.

Cost of Manufactured Homes Sold. The cost of manufactured homes sold, including sales commissions, was \$4.9 million, or \$18,600 per unit, for the six months ended June 30, 2006, as compared to \$22.1 million, or \$13,400 per unit, for the six months ended June 30, 2005, a decrease of \$17.2 million. The decrease primarily was due to the decrease in the number of manufactured homes sold, as discussed above. The Company recorded a net gain on the sale of manufactured homes of \$0.8 million and \$1.8 million, respectively, in the six months ended June 30, 2006 and 2005.

Retail Home Sales, Finance and Insurance Expense. For the six months ended June 30, 2006, total retail home sales, finance and insurance expense was \$4.7 million as compared to \$6.9 million for six months ended June 30, 2005, a decrease of \$2.2 million. This decrease primarily is due to the down-sizing of our sales and marketing organization in which we terminated over 150 employees in the fourth quarter of 2005, primarily in sales management.

Property Management Expense. Property management expense for the six months ended June 30, 2006 was \$3.2 million, as compared to \$4.5 million for the six months ended June 30, 2005, a decrease of \$1.3 million, or 30%. The decrease primarily is due to reduced advertising expenses and headcount reductions resulting in lower salaries and benefits and travel expenses.

General and Administrative Expense. General and administrative expense for the six months ended June 30, 2006 was \$9.4 million, as compared to \$11.9 million for the six months ended June 30, 2005, a decrease of \$2.5 million, or 21%. The decrease primarily was due to lower salaries and benefits and the related travel expenses, as well as a reduction in professional services resulting from Sarbanes-Oxley implementation costs incurred last year.

Depreciation and Amortization Expense. Depreciation and amortization expense for the six months ended June 30, 2006 was \$43.4 million, as compared to \$35.1 million for the six months ended June 30, 2005, an increase of \$8.3 million, or 24%. The increase primarily is due to depreciation on the significant amount of mobile homes and community improvements placed in service during the latter half of 2005.

Loss on Sale of Airplane. During the six months ended June 30, 2006, the Company sold one of its two

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aircraft for \$1.2 million in cash, incurring a loss on the sale of approximately \$0.5 million.

Interest Expense. Interest expense for the six months ended June 30, 2006 was \$39.6 million, as compared to \$32.7 million for the six months ended June 30, 2005, an increase of \$6.9 million, or 21%. The increase is due to a higher outstanding average debt balance of approximately \$131 million, as well as higher effective weighted average interest rates on our variable rate debt.

Income Taxes. The Company expects to have no aggregate income tax expense or benefit for the year ended December 31, 2006. However, we have restated our Consolidated Financial Statements for the six months ended June 30, 2006 to (a) provide for an intra-period income tax allocation whereby we recorded an income tax benefit from continuing operations of \$4.6 million (as restated) (including \$1.2 million (as restated) deferred from the first quarter) and an income tax expense from discontinued operations of \$11.3 million (as restated) in accordance with SFAS No. 109 and (b) deferred the resulting income tax benefit from continuing operations to future interim periods using an estimated annual effective tax rate in accordance with APB 28 and FIN 18.

Minority Interest. Minority interest for the six months ended June 30, 2006 was \$0.4 million (as restated) as compared to \$1.2 million for the six months ended June 30, 2005, a decrease of \$0.8 million, or 66%. The decrease primarily was due to a decrease in the minority interest share of our net loss to 3.5% from 5.2% for the first six months of 2005.

Discontinued Operations. On December 15, 2005, the Company held an auction in which it offered 71 communities for sale. The Company ultimately entered into contracts to sell 38 of these communities. During 2006, the Company entered into contracts to sell another three communities. As of June 30, 2006 the Company has closed 36 of these transactions, comprising \$77.0 million of cash proceeds net of related debt, defeasance and other closing costs of \$59.6 million. Gains of \$25.9 million were recorded on the sales of these communities in the first six months of 2006.

Preferred Stock Dividend. On March 2, 2006, the ARC board of directors declared a quarterly cash dividend of \$0.5156 per share for each of the 5,000,000 outstanding shares of our Series A Preferred Stock, paid April 28, 2006. On June 8, 2006, the ARC board of directors declared another quarterly cash dividend of \$0.5156 per share for each of the 5,000,000 outstanding shares of our Series A Preferred Stock, paid July 28, 2006. For the six months ended June 30, 2006, these dividends totaled \$5.2 million. For the six months ended June 30, 2005, the dividends declared also were \$0.5156 per share, or \$5.2 million.

Net Loss Attributable to Common Stockholders. As a result of the foregoing, our net loss attributable to common stockholders was \$9.8 million (as restated) for the six months ended June 30, 2006, as compared to \$34.1 million for the six months ended June 30, 2005, a decrease in net loss of \$24.3 million or 71%.

LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2006, we had approximately \$32.2 million of cash and cash equivalents and \$72.2 million available under the terms of the lease receivables line of credit. This reflects the use of a significant portion of the excess net cash proceeds from the sale of 36 communities in the first six months of 2006 to repay certain mortgage and floorplan and other indebtedness. As of June 30, 2006, we closed sales transactions for 36 of the 41 communities we held as discontinued as of December 31, 2005 obtaining cash proceeds of \$77.0 million net of related debt repayment and defeasance and other costs of \$59.6 million.

Our plan for the second half of 2006 is to (i) continue to manage our results against our detailed budget focused on operating effectiveness at the community level; (ii) adjust the price and cost structure, including commissions, of our marketing programs in the sales and leasing of homes; (iii) control our expense structure consistent with maintaining effective controls over the business; (iv) make capital expenditures as necessary and appropriate to keep our communities up to our standards; (v) purchase homes for sale or lease as demand warrants and funds permit; and (vi) consider potential acquisition opportunities to compliment and enhance our business.

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Our short-term liquidity needs include funds for dividend payments on our \$125 million Series A cumulative redeemable preferred stock bearing a dividend rate of 8.25% per annum (approximately \$10.3 million annually), funds for capital expenditures for our existing communities, funds for purchases of manufactured

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homes and funds to service our debt.

We expect to fund our short-term liquidity needs described above through net cash provided by operations, borrowings under our \$35 million floorplan line of credit, borrowings under our \$150 million lease receivables line of credit, borrowings under our \$125 million consumer finance facility, net proceeds from the sales of communities and net proceeds from the July 2006 refinancing of our variable rate mortgage indebtedness described in Recent Developments.

Our ability to obtain funding from time to time under the lease receivables facility, the floorplan line of credit and the consumer finance debt facility will be subject to certain conditions, and we make no assurance that we will continue to meet any or all of these conditions in the future. If we are unable to meet the conditions necessary to continue funding under these facilities, we may not be able to fund operations, capital expenditures, manufactured home sale consumer loans, manufactured home purchases and distributions on our preferred stock and our results of operations could be adversely affected.

We expect to meet our long-term liquidity requirements for the funding of potential acquisitions, purchases of additional rental homes, purchase, sale and financing of homes to new residents in our communities, funding of distributions on our preferred stock and other capital improvements through net cash provided by operations, borrowings under secured and unsecured indebtedness, retail home sales and potential other financing transactions.

We expect to refinance our indebtedness as or before it comes due. On July 11, 2006, we entered into a \$230 million mortgage debt facility in which we repaid approximately \$175 million of our senior variable rate mortgage and our revolving credit mortgage facility and, with the additional \$55 million, partially repaid our lease receivables facility and our consumer finance facility. We also intend to use the excess funds to complete a partial defeasance of one of our communities that is held for sale. As a result of the refinancing, we increased the proportion of our fixed rate debt to over 90% from 75% prior to the refinancing. This refinancing also resulted in lower interest rates as compared with rates currently in effect on our senior variable rate mortgage, our revolving credit mortgage facility, our lease receivables facility and our consumer finance facility.

Based on present commitments and community sales plans, the Company believes it will be able to fund its debt service obligations, capital expenditures and home purchases from operating cash flows and the financing sources described above. However, we cannot assure that we will be able to complete the sales of the remaining communities currently held for sale, sell manufactured homes or refinance expiring credit lines. Should we not be able to obtain sufficient funds for these purposes, we may determine that it is necessary to substantially defer or eliminate some or all of our objectives that require these funds, including home purchases, consumer loans, and non-recurring capital expenditures.

CASH FLOWS

Comparison of the Six Months Ended June 30, 2006 to the Six Months Ended June 30, 2005

Cash provided by operations was \$15.5 million and \$1.0 million for the six months ended June 30, 2006 and 2005, respectively. The increase in cash provided by operations for 2006 as compared to 2005 primarily was due to increased net segment income in the real estate segment, reduced net segment losses in the retail sales, finance and insurance segments and reduced property management and general and administrative expenses, partially offset by an increase in interest payments.

Cash provided by investing activities was \$118.1 million in the six months ended June 30, 2006, compared with cash used in investing activities of \$39.8 million in the same period in 2005. The increase in cash from investing activities primarily was due to reduced community improvement spending by \$30.6 million, increased net proceeds from the sale of communities by \$74.7 million and reduced manufactured home purchases by \$61.6 million.

Cash used in financing activities was \$129.3 million in the six months ended June 30, 2006, compared with cash provided by financing activities of \$22.4 million in the same period in 2005. The decrease in cash used in financing activities primarily was due to the repayment of \$147.4 million of debt, primarily in relation to the sales of communities, in the first six months of 2006, compared with \$94.4 million of debt repaid in the first six months of

2005. Also, in the first six months of 2006 we received proceeds from the issuance of additional indebtedness of \$30.5 million, as compared with \$155.5 million in the first six months of 2005. Partially offsetting this was the discontinuance of the payment of the common and OP unit dividends, which were paid in the first six months of 2005 but were not paid in the first six months of 2006.

INFLATION

Inflation in the U.S. has been relatively low in recent years and did not have a material impact on our results of operations for the three and six months ended June 30, 2006 and 2005. Although the impact of inflation has been relatively insignificant in recent years, it remains a factor in the United States economy and may increase the cost of acquiring or replacing property, plant, and equipment and the costs of labor and utilities.

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COMMITMENTS

At June 30, 2006, we had approximately \$1,063.2 million of consolidated indebtedness outstanding with the following repayment obligations (in thousands):

	Principal Commitments			Interest Commitments		
	Fixed	Variable	Total	Fixed	Variable	Total
2006	\$ 12,514	\$ 58,764	\$ 71,278	\$ 26,793	\$ 10,116	\$ 36,909
2007	10,115	121,270	131,385	52,392	9,166	61,558
2008	53,655	60,645	114,300	50,244	5,428	55,673
2009	103,139		103,139	44,344	2,251	46,595
2010	13,212		13,212	42,168	2,251	44,419
Thereafter	599,087	25,780	624,867	198,378	54,568	252,946
Commitments	791,722	266,459	1,058,181	414,319	83,780	498,100
Unamortized premium	5,012		5,012			
	\$ 796,734	\$ 266,459	\$ 1,063,193	\$ 414,319	\$ 83,780	\$ 498,100

	Total Debt Commitments		
	Fixed	Variable	Total
2006	\$ 39,307	\$ 68,880	\$ 108,187
2007	62,508	130,436	192,944
2008	103,899	66,074	169,973
2009	147,483	2,251	149,734
2010	55,380	2,251	57,631
Thereafter	797,465	80,348	877,813
Commitments	1,206,042	350,240	1,556,282
Unamortized premium	5,012		5,012
	\$ 1,211,054	\$ 350,240	\$ 1,561,294

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our future income, cash flows and fair values relevant to financial instruments are dependent upon prevalent market interest rates. Market risk refers to the risk of loss from adverse changes in market prices and interest rates. We use some derivative financial instruments to manage, or hedge, interest rate risks related to our borrowings. We do not use derivatives for trading or speculative purposes and only enter into contracts with major financial institutions based on their credit rating and other factors.

As of June 30, 2006, our total debt outstanding was approximately \$1,063.2 million, comprised of approximately \$796.7 million, or 75% of our total consolidated debt, subject to fixed interest rates and approximately \$266.5 million, or 25% of our total consolidated debt, subject to variable interest rates.

If LIBOR and the prime rate were to increase by one eighth of one percent (0.125%), the increase in interest expense on the variable rate debt would decrease future earnings and cash flows by approximately \$333,000 annually.

Interest risk amounts were determined by considering the impact of hypothetical interest rates on our financial instruments. These analyses do not consider the effect of any change in overall economic activity that could occur in that environment. Further, in the event of a change of that magnitude, we may take actions to further mitigate our exposure to the change. However, due to the uncertainty of the specific actions that would be taken and their possible effects, these analyses assume no changes in our financial structure.

The fair value of debt outstanding as of June 30, 2006 was approximately \$1,059.3 million.

The following table sets forth certain information with respect to our indebtedness outstanding as of June 30, 2006 (dollars in thousands):

	Amount of Debt	Percentage of Total Debt	Weighted Average Interest Rate	
Fixed Rate Debt				
Senior fixed rate mortgage due 2009	\$ 87,237	8.2	% 5.05	%
Senior fixed rate mortgage due 2012	279,761	26.3	% 7.35	%
Senior fixed rate mortgage due 2014	194,169	18.4	% 5.53	%
Various individual fixed rate mortgages due 2006 through 2031	135,239	12.7	% 7.23	%
Senior exchangeable notes due 2025	96,600	9.1	% 7.50	%
D.A.M. Preferred Partnership Units due 2006	2,499	0.2	% 7.00	%
Other loans	1,230	0.1	% 6.97	%
	796,735	75.0	% 6.65	%
Variable Rate Debt				
Senior variable rate mortgage due 2007	116,757	11.0	% 8.33	%
Revolving credit mortgage facility due 2006	58,764	5.5	% 8.08	%
Trust preferred securities due 2035.	25,780	2.4	% 8.73	%
Consumer finance facility due 2008	19,345	1.8	% 8.33	%
Lease receivable facility due 2008	41,300	3.9	% 9.46	%
Floorplan lines of credit due 2007	4,513	0.4	% 9.00	%
	266,459	25.0	% 8.50	%
	\$ 1,063,194	100.0	% 7.12	%

ITEM 4. CONTROLS AND PROCEDURES

(a) Restatement of Previously Issued Financial Statements

As more fully described in Note 2 of the Notes to Consolidated Financial Statements, the Company has restated its interim consolidated financial statements for the quarter and six months ended June 30, 2006 to correct its intra-period income tax accounting as presented in the original Form 10-Q for the quarter and six months ended June 30, 2006. As a result of the restatement of its previously issued interim consolidated financial statements as of and for the quarter and six months ended June 30, 2006, management has assessed the impact of the restatement on its disclosure controls and procedures as of June 30, 2006, as discussed below.

(b) Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) is recorded, processed and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to our management, including our principal executive and principal financial officers, or other persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

In light of the restatement referred to in (a) above, management, with the participation of the Company's principal executive and financial officers, re-evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2006. Based on this re-evaluation and as a result of the identification of the material weakness in our internal control over financial reporting discussed below, management has concluded that our disclosure controls and procedures were not effective as of June 30, 2006.

A material weakness is a control deficiency, or a combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. Management determined that the following control deficiency constitutes a material weakness in our internal control over financial reporting at June 30, 2006:

The Company did not maintain effective internal controls over the presentation of its income tax provision. Specifically, the Company did not maintain effective controls to ensure that its intra-period income tax allocation between continuing and discontinued operations was in accordance with generally accepted accounting principles. This control deficiency resulted in the restatement of the Company's consolidated financial statements for each of the first three quarters of the year ended December 31, 2006. Additionally, this control deficiency could result in a misstatement of the Company's income tax provision that would result in a material misstatement to the annual or interim consolidated financial statements that would not be prevented or detected.

(c) Plan for Remediation of Material Weakness

We believe that the steps described below, which have already been taken in connection with the preparation of the December 31, 2006 financial statements, remediate the material weakness in our internal control over financial reporting described in (b) above:

- (1) The Company plans to perform a more rigorous review of its income tax provision and related intra-period tax allocations in conjunction with the preparation of its interim and annual consolidated financial statements; and
- (2) The Company plans to perform a more rigorous review of its income tax disclosure requirements in conjunction with the preparation of its interim and annual consolidated financial statements.

(d) Changes in Internal Control Over Financial Reporting

There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 6. EXHIBITS

(a) Exhibits:

See Exhibit Index

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SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

AFFORDABLE RESIDENTIAL COMMUNITIES INC.

Date: March 12,
2007

By:

/s/ Lawrence E. Kreider
Lawrence E. Kreider
Executive Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer and a duly
authorized officer)

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EXHIBIT INDEX

Exhibit Number	Exhibit Title
3.1*	Articles of Amendment and Restatement of Affordable Residential Communities Inc. (incorporated by reference to Exhibit 3.1 to the Annual Report on Form 10-K of Affordable Residential Communities Inc. for the year ended December 31, 2003 (file number 001-31987)).
3.2*	Amended and Restated Bylaws of Affordable Residential Communities Inc. (incorporated by reference to Exhibit 3.2 to the Annual Report on Form 10-K of Affordable Residential Communities Inc. for the year ended December 31, 2003 (file number 001-31987)).
10.1*	Form of Affordable Residential Communities Inc. 2003 Equity Incentive Plan Non-Qualified Stock Option Agreement.
10.2*	Time Share Agreement dated July 15, 2006, between Larry D. Willard and Affordable Residential Communities LP.
10.3*	Time Share Agreement dated July 15, 2006, between James F. Kimsey and Affordable Residential Communities LP.
10.4*	Loan Agreement dated July 11, 2006 among ARCHL06 LLC, ARC18TX LP, ARC18FLD LLC, ARC18FLSH LLC, ARCFLMC LLC and ARCFLSV LLC, as co-borrowers and Merrill Lynch Mortgage Lending, Inc.
10.5*	Guarantee of Non-Recourse Obligations dated July 11, 2006 between Affordable Residential Communities LP and Merrill Lynch Mortgage Lending, Inc.
10.6*	Rights Agreement, dated as of July 11, 2006, by and between the Company and American Stock Transfer & Trust Company.
10.7*	Second Amendment to Credit Agreement, dated as of April 5, 2006, by and among, ARC Housing LLC, ARC Housing TX LP, (Borrowers), and Merrill Lynch Mortgage Capital Inc., (Lender).
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act, as amended.
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act, as amended.
32.1	Certification of Chief Executive Officer of Affordable Residential Communities Inc., pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer of Affordable Residential Communities Inc., pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Previously filed